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In The
Supreme Court of the United States

KATHI COOPER, et al.,

Petitioners,

v.

IBM PERSONAL PENSION PLAN & IBM CORP.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Section 204(b)(1)(H)(i), 29 U.S.C. § 1054(b)(1)(H)(i), of the Employee Retirement Income Security Act ("ERISA"), provides that a defined-benefit pension plan violates the Act's proscription against age discrimination if "the rate of an employee's benefit accrual is reduced, because of the attainment of any age."

Respondents' defined benefit pension plan uses a "cash balance formula" to calculate benefits, under which an employee's pension entitlement attributable to any single year of work decreases depending upon how close in age the employee is to the normal retirement age of 65. The formula accomplishes this result by adding a hypothetical "interest credit" to each employee's fictional account for each year of the employee's age below retirement age, thus giving younger employees more interest credits and greater pension entitlements than older employees. Respondents' pension plan also credited younger employees an unearned increase to their opening cash balance accounts but limited older employees to their vested benefits under the prior plan.

The questions presented are:

Whether a defined benefit plan using a cash balance formula violates ERISA Section 204(b)(1)(H)(i) because an employee's rate of benefit accrual decreases the closer he is to retirement age.

Whether a defined benefit plan that gave younger employees an unearned increase in their opening cash balance accounts that was denied to older employees violated ERISA Section 204(b)(1)(H)(i).

PARTIES TO THE PROCEEDING

The petitioners in this Court include Kathi Cooper and Beth Harrington as class representatives of the class of IBM pension plan participants certified by the district court. The class has more than 250,000 current and retired IBM employees. They were plaintiffs in the district court and appellees before the court of appeals.

The respondents in this Court are IBM Corporation and IBM Personal Pension Plan. They were the defendants in the district court and the appellants before the court of appeals.

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PETITION FOR A WRIT OF CERTIORARI

The Seventh Circuit's decision below is enormously important because it threatens to deprive millions of older Americans of congressionally-enacted protections against age discrimination in their pension plans. The court of appeals upheld a pension benefit formula used by one of the nation's largest companies that admittedly provides lower pension benefits to older employees than younger employees with the same service and salary history, notwithstanding the express nondiscrimination mandate of the Employee Retirement Income Security Act ("ERISA") condemning that result.

No one disputes that under respondents' formula an older employee who does the same work as a younger employee for the same salary accrues pension benefits attributable to that year's work at a rate that is lower than the rate at which the younger employee accrues benefits. Nor is there any dispute that the exclusive reason for the different entitlement is the older employee's age, in particular that he is closer to normal retirement age. As demonstrated by the record in this case, respondent IBM understood precisely what the actuarial effect was of its policy, including its intended and discriminatory impact in terms of the age of its employees, which its formula then fully realized.

Also undisputed are the monetary significance of the resulting discrimination and the extent to which such discrimination is widespread in existing cash balance plans. The parties stipulated that if the courts agreed that the discrimination violated ERISA, petitioners were entitled to $1.4 billion in increased benefits from respondents. That striking amount, however, is literally just the tip of the iceberg of those adversely affected by the Seventh Circuit's decision. Nationwide there are more than

eight million employees of companies that have similar pension plans.[1]

The multiple flaws in the Seventh Circuit's reasoning also present important legal issues warranting this Court's immediate attention. In an opinion written by Judge Frank Easterbrook, the lower court ignored the plain meaning of the statutory language, replaced the legal definition supplied by Congress for unlawful age discrimination with the court's own economic theories about age discrimination, and erroneously equated two distinct kinds of pension plans (defined-*benefit* plans and defined-*contribution* plans) that are fundamentally different in their economic operation and, even more significant, in their treatment under ERISA. The court's rulings in these respects conflict with the decisions of other circuit courts arising under ERISA. Unlike Judge Easterbrook, those courts have recognized the distinctions that Congress carefully drew in ERISA between defined benefit plans and defined contribution plans, and those other courts have concluded that plans such as IBM's Plan that use a cash balance formula are governed by ERISA's requirements for defined benefit plans.

Finally, neither Congress's recent amendment of ERISA (*see* Pension Protection Act of 2006, P.L. 109-280, § 701) nor the existence of several other cases pending in the lower courts raising similar legal issues provides reason to delay this Court's review. The congressional amendment is prospective only and does not affect the rights of millions of employees, including petitioners here. The ongoing lower court litigation merely underscores the existing and increasing significance of the legal issues raised in this case, notwithstanding the recent congressional enactment. It would, moreover, be especially unjust

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[1] The Pension Benefit Guaranty Corp., Pension Insurance Data Book for 2005, http://www.pbgc.gov/docs/2005databook.pdf, at 61, 62.

for the Court to delay ruling on the legal issues presented, thereby forever precluding the 250,000 members of the class represented by petitioners in this case from recovering for what the Court later concludes is unlawful age discrimination. The current case presents the legal issue in a clear and unencumbered manner and no further lower court consideration is warranted prior to this Court's plenary review.

OPINIONS BELOW

The opinion of the district court granting summary judgment in favor of petitioners on the issue of liability (App. 14-41) is reported at 274 F. Supp. 2d 1010. The opinion of the court of appeals (App. 1-13) is reported at 457 F.3d 636.

JURISDICTION

The judgment of the court of appeals was entered on August 7, 2006. Petitions for rehearing and rehearing en banc were denied on September 1, 2006. App. 45. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case concerns the meaning of two subsections of Section 204(b) of the Employment Retirement Security Act (ERISA), 29 U.S.C. § 1054(b).

Section 204(b)(1)(H)(i) governs age discrimination in defined benefit plans and provides in pertinent part:

> [A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, . . . the rate of an employee's benefit accrual is reduced, because of the attainment of any age.

ERISA Section 204(b)(2)(A) governs age discrimination in defined contribution plans and provides in pertinent part:

> A defined contribution plan satisfies the requirements of this paragraph if, under the plan, . . . the rate at which amounts are allocated to the employee's account is not reduced, because of the attainment of any age.

STATEMENT OF THE CASE

1. ERISA permits employers to choose one of two fundamentally different plan designs to take advantage of the tax incentives provided for "qualified" pension plans. One option is to create *a defined contribution* plan (such as the widely used 401(k) plan), in which the employer typically contributes a percentage of the employee's compensation annually to an investment account created for the employee. The employee's pension entitlement is the value of his account, consisting of the employer's annual contributions plus any earnings flowing from the employee's investment of those deposits. *See Berger v. Xerox Corp. Retirement Income Guarantee Plan*, 338 F.3d 755, 758 (7th Cir. 2003). The employee owns the funds in the account and bears the investment risk. Because an employer's obligation under such a plan extends only to the annual contribution to the employee's account, ERISA's age discrimination rule for defined contribution plans requires only that an employer contribute an equal percentage of salary to each employee's account regardless of age. ERISA Section 204(b)(2)(A), 29 U.S.C. § 1054(b)(2)(A). *See generally* Zelinsky, *Cooper v. IBM Personal Pension Plan*, Social Science Research Network, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=926560, at 3-12 ("Zelinsky Cooper Critique").[2]

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[2] Professor Edward A. Zelinsky is a leading legal scholar with respect to pensions in general and the cash balance formula in particular.

(Continued on following page)

The employer's other option is to create *a defined benefit* plan in which the employer promises to pay an employee a guaranteed benefit amount at "normal retirement age." This benefit is typically calculated as a percentage of the employee's compensation (averaged over a specified time period or the employee's entire career) times his years of service. The pension entitlement provided by the plan is the "accrued benefit" at normal retirement age (which the plan selects but cannot be later than age 65). *Berger*, 338 F.3d at 758. ERISA requires that the accrued benefit be provided in the form of an annuity at normal retirement age. ERISA Section 204(c)(3), 29 U.S.C. § 1054(c)(3). A plan may offer optional benefit forms, such as a lump sum, but the benefits paid out cannot be less than the actuarial equivalent of the annuity at normal retirement age. *Berger*, 338 F.3d at 759; *see also Esden v. Bank of Boston*, 229 F.3d 154, 162-164 (2d Cir. 2000). The employee does not own any of the plan's assets but instead has a contract right to be paid benefits at normal retirement age as provided by the plan's terms. Consistent with the requirement that an employee's pension entitlement is the accrued benefit at normal retirement age, the age discrimination rule applicable to defined benefit plans prohibits any cessation or reduction in the rate at which an employee accrues this benefit on account of age. ERISA Section 204(b)(1)(H)(i), 29 U.S.C. § 1054(b)(1)(H)(i).

This Court, in *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439-440 & n.3 (1999) (citations omitted), explained these fundamental differences between defined contribution and defined benefit plans:

See Zelinsky, *The Defined Contribution Paradigm*, 114 Yale L. J. 451 (2004); Zelinsky, *The Cash Balance Controversy*, 19 Va. Tax Rev. 683 (2000).

> A defined contribution plan is one where employees and employers may contribute to the plan, and "'the employer's contribution is fixed and the employee receives whatever level of benefits the amount contributed on his behalf will provide.'" . . . A defined contribution plan "provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account." ERISA § 3(34); 29 U.S.C. § 1002(34). . . .
>
> A defined benefit plan, on the other hand, consists of a general pool of assets rather than individual dedicated accounts. Such a plan, "as its name implies, is one where the employee, upon retirement, is entitled to a fixed periodic payment." . . . [T]he employer typically bears the entire investment risk and – short of the consequences of plan termination – must cover any underfunding as the result of a shortfall that may occur from the plan's investments. . . .
>
> . . . [Defined benefit plan] members have a right to a certain defined level of benefits, known as "accrued benefits." That term, for purposes of a defined benefit plan, is defined as "the individual's accrued benefit determined under the plan [and ordinarily is] expressed in the form of an annual benefit commencing at normal retirement age." ERISA § 3(23)(A), 29 U.S.C. § 1002(23)(A). . . .
>
> . . . .
>
> By contrast, an "accrued benefit" for purposes of defined contribution plans means "the balance of the individual's account." ERISA § 3(23)(B), 29 U.S.C. § 1002(23)(B).

In an effort to circumvent ERISA's sharp distinction between defined benefit and defined contribution plans, numerous employers have amended their defined benefit plans to adopt a "cash balance formula" (often referred to as a "cash balance plan"). The formula describes the employee's

benefit in a manner designed to resemble the operation of a defined contribution plan even though the plan legally remains a defined benefit plan. *Esden*, 229 F.3d at 158. The typical cash balance formula purports to compute an employee's "accrued benefit" as a hypothetical account balance, to which putative "pay credits" and "interest credits" are added each year. In reality, "the employee has no actual account, the employer makes no contributions to an employee account, and so there is no account balance to which interest might be added." *Berger*, 338 F.3d at 758. Rather, the employee's pension entitlement under a cash balance formula remains the accrued benefit earned each year, which equals the amount of both that year's pay credit and the value of the future "interest credits" on that amount through the employee's normal retirement age, divided by an annuity factor specified in the plan. *Id.* at 758-759; *Esden*, 229 F.3d at 158-159. In short, the cash balance formula differs from traditional defined benefit formulas only by injecting hypothetical steps into the calculation of the accrued benefit. In the end, it is simply a mathematical formula that calculates a retirement benefit.

The following chart shows the accrued benefit an employee earns each year under a cash balance formula providing a 5% pay credit and a 5% interest credit for differently aged employees earning $50,000 per year, using a typical annuity conversion factor of 10.

Age	Pay Credit Projected to 65	Annual Accrued Benefit at 65	Accrued Benefit as % of Pay
25	17,600	1,760	3.52%
35	10,800	1,080	2.16%
45	6,633	663	1.33%
50	5,197	520	1.04%
55	4,072	407	0.81%
60	3,191	320	0.64%
64	2,625	262	0.53%

The result of this formula is that as an employee advances a year in age the rate of benefit accrual decreases both as a dollar amount and as a percentage of pay.

Under this formula, the actual amount of the accrued benefit – and the rate of accrual of that benefit – are always smaller for an older employee than for a younger employee with the same salary and service history. *See* IBM's 7th Cir. Appendix ("CA App.") at 380-381. This accrual pattern is identical to what would result from a conventional defined benefit plan that expressly provided that the accrued benefit equals a declining percentage of each year's pay for each year that an employee ages (*i.e.*, a 25-year-old employee accrues a benefit equal to 3.52% of pay, while a 45-year-old accrues a benefit equal to 1.33% of pay and a 64-year-old accrues a benefit equal to .53% of pay). IBM candidly admitted (IBM 7th Cir. Reply Br. 14) that a traditional defined benefit plan that provided such a declining rate of benefit accrual would violate ERISA Section 204(b)(1)(H)(i).

2. IBM's Plan adopted a cash balance formula effective July 1, 1999. CA App. 213. The formula determines a participant's benefit by reference to "pay credits" of 5% of each year's salary to a participant's hypothetical Personal Pension Account ("PPAcct") as well as annual "interest credits" on its dollar amount at the rate of the one-year Treasury bill rate plus 1% to the PPAcct. *Id.*, 242-243. The Plan states that the resulting account balance constitutes a participant's accrued benefit. *Id.*, 240, § 11.1. If a participant defers the receipt of benefits until normal retirement age, the participant is entitled to an annuity, which is the "default" benefit form, calculated by dividing the hypothetical PPAcct by an annuity factor provided in the Plan. *Id.*, 245, § 12.2(b).

IBM's actuaries undertook an "Age Discrimination Analysis" of the cash balance formula prior to its adoption. Plaintiffs-Appellees' 7th Cir. Supplemental Appendix ("CA Supp. App.") 76. Part of the Analysis focused on the age-65 annuities that would be earned by employees with the same salary and years of service but with different ages. The results showed that the increase in the age-65 annuity earned each year under the cash balance formula, *i.e.*, the rate of benefit accrual, for the younger employee exceeded the rate for the older employee. In addition, the amount of the annuity earned each year by an employee decreased as the employee aged. *Id.*, 79-86. The following chart illustrates these effects of IBM's cash balance formula. It shows the annual rate of benefit accrual for differently aged employees using a 5% pay credit and a 5.5% interest credit (the initial applicable rate under IBM's formula, CA App. 391).

Age	Accrual Rate	Age	Accrual Rate	Age	Accrual Rate
21	4.667%	36	2.090%	51	0.936%
22	4.423%	37	1.981%	52	0.887%
23	4.193%	38	1.878%	53	0.841%
24	3.974%	39	1.780%	54	0.797%
25	3.767%	40	1.687%	55	0.756%
26	3.571%	41	1.599%	56	0.716%
27	3.384%	42	1.516%	57	0.679%
28	3.208%	43	1.437%	58	0.644%
29	3.041%	44	1.362%	59	0.610%
30	2.882%	45	1.291%	60	0.578%
31	2.732%	46	1.224%	61	0.548%
32	2.589%	47	1.160%	62	0.520%
33	2.454%	48	1.099%	63	0.492%
34	2.327%	49	1.042%	64	0.467%
35	2.205%	50	0.988%	65	0.442%

As the chart shows, the rate of benefit accrual for participants in IBM's plan declines steeply solely on the basis of their age. The oldest participant's benefit accrual rate is less than 10% of a 21-year-old participant's benefit accrual rate. In short, the Plan's cash balance formula provides participants the same declining rate of benefit accrual based on age as would a traditional defined benefit plan that simply stated in its text the above accrual rates without any formula to disguise the effect.

3. As part of the 1999 conversion to the cash balance formula, IBM chose to provide a one-time unearned accrued benefit, the Always Cash Balance enhancement (ACBE), to younger employees based solely on age. To implement the instant accrual of this benefit for younger workers, IBM used a "comparison formula" to determine the hypothetical dollar amount of each employee's opening PPAcct. CA App. 268-269, § 17.5(b); *Id.*, 391.

The results produced by the ACBE depended entirely on an employee's age as of June 30, 1999, the day before the plan conversion. For employees under a certain age (about 42), the ACBE provided a larger amount – up to twice as much – than the present value of their existing benefit. For older employees, the present value of their existing benefit exceeded the ACBE amount, so the conversion formula provided them no additional benefit solely because of their age. Thus, younger employees received an instantaneous increase in their pension benefit while older workers received no increase at all. CA Supp. App. 87. The following chart demonstrates the discriminatory treatment of an older employee compared to a younger employee with the same salary and service history (derived from CA App. 434, 438-439):

Line#			
1	Age at 6/30/99	38	46
2	Service at 6/30/99	9	9
9	Age 65 Annuity at 6/30/99	7,140	7,041
14	Present Value Formula at 7/1/99	15,762	24,775
15	ACBE at 7/1/99	19,757	19,757
	ACBE Increase in Opening Balance [15-14]	3,995	0
26	CB Age 65 Annuity at 7/1/99	7,572	6,187
	ACBE Increase in Age 65 Annuity [26-9]	432	0

IBM management understood that these differences in additional benefits depended entirely upon employees' ages on June 30, 1999. In a May 4, 1999, e-mail to senior IBM managers, the Plan's enrolled actuary explained that:

> Due to the nature of the IBM Retirement Plan vs. the Personal Pension Account, younger employees will benefit the most from this Always Cash Balance enhancement. On average, very young employees (in their 20's), could see their benefit double due to the enhancement, while a person who is in their early 40's might only see a 10% increase due to the Always Cash Balance enhancement. Older employees (over 45) will generally not be covered by the Always Cash Balance enhancement. CA Supp. App. 87.

He concluded that "[a]s you can see, the excess percentage of the ACB over the basic opening account balance is directly related to age." *Id.*, 88.

This gratuitous benefit increase for younger employees affected both the amount of the immediate benefit to which employees were entitled as a lump-sum distribution and, to an even greater extent, the age-65 accrued benefit derived from that opening account balance projected

forward to normal retirement age at the Plan's interest crediting rate. Thus, participants who received the ACBE and terminated employment on July 1, 1999, would have received accrued benefits significantly higher (as much as double) what they were entitled to the day before.

4. The district court concluded that under IBM's cash balance formula, the rate of an employee's benefit accrual was reduced every year because of the increase in his age, in violation of ERISA Section 204(b)(1)(H)(i). App. 32-37. The district court also ruled that the ACBE violated ERISA Section 204(b)(1)(H)(i) because it provided an immediate accrual of unearned benefits for younger employees but no increase for older workers solely based on the employee's age. App. 42-43. The parties then settled all other issues, including increased benefits for the class, and the district court entered judgment. App. 42-44. The monetary relief awarded to the class with respect to the two issues raised by this Petition totals $1.4 billion in increased benefits.

5. The Seventh Circuit reversed on both issues. App. 1-13. Writing for the court, Judge Easterbrook concluded that cash balance plans are functionally equivalent, in economic terms, to defined contribution plans and should be governed by the same age discrimination principles as defined contribution plans. App. 1-2. Judge Easterbrook also ruled that, despite the different statutory terms used by Congress, ERISA's prohibition of age discrimination in defined benefit plans was essentially identical to the provision governing age discrimination in defined contribution plans. App. 3-5. Consequently, he opined that the cash balance formula did not violate ERISA because it provided that the employer would make hypothetical annual pay credit "contributions" to employees' hypothetical accounts at an equal rate regardless of an employee's age, even though those contributions resulted in higher benefits for younger employees at normal retirement age. The opinion attributed the higher benefits provided to younger workers to the "time value of money" rather than age discrimination because younger workers could wait

longer than older workers to receive their benefits. App. 4-6.

With respect to the Always Cash Balance Enhancement provided to younger but not older workers, Judge Easterbrook similarly held that there was no impermissible age discrimination under ERISA. Judge Easterbrook contended that older workers did not lose any benefits because of age just because younger workers are given an additional economic benefit. He further asserted that younger workers can properly be granted a gratuitous benefit increase denied to older workers. App. 12.

REASONS FOR GRANTING THE WRIT

It is axiomatic that it is not the role of the federal judiciary in statutory construction to second guess the wisdom of the policy judgments made by Congress. Yet, that is precisely what the Seventh Circuit, through Judge Easterbrook's opinion, did in this case. Based on Judge Easterbrook's preferred economic theory of what should and should not constitute impermissible age discrimination, the appellate court determined that it was sound economic policy for respondents to adopt a pension plan that indisputably provides lower benefits to older employees than to younger employees because of their age. Congress, however, made a very different policy choice in ERISA by expressly barring pension plans from drawing that very distinction based on age. And, notwithstanding the lower court's Herculean efforts to twist the plain meaning of the statutory language to create an exemption from ERISA's nondiscrimination mandate, the statutory language Congress actually enacted admits of no such exception.

As described below, the Seventh Circuit's improper substitution of its own policy views for those of Congress resulted in its upholding two distinct aspects of respondents' pension plan: the cash balance formula and its method of assigning initial benefits to older and younger employees. Both rulings are legally erroneous. The first

error, however, is the more far-reaching because it conflicts with decisions of three other circuits and potentially affects millions of employees, even beyond the more than 250,000 directly implicated in this case. Although the second issue is more case specific, we urge the Court to grant both issues in the event that the Court grants the first issue. Granting both would be proper because the lower court treated its resolution of the first issue as effectively dispositive of the second, and resolving both issues is required to provide full relief to petitioners. The second issue also presents a distinct circuit conflict.

I. REVIEW IS WARRANTED OF THE SEVENTH CIRCUIT'S ERRONEOUS CONCLUSION THAT RESPONDENTS' DEFINED BENEFIT PENSION PLAN DOES NOT VIOLATE ERISA'S PROHIBITION AGAINST AGE DISCRIMINATION.

IBM's pension plan plainly discriminates on the basis of age. The employee's rate of benefit accrual based on a single year's work depends not just on salary, but also on age. The formula is both straightforward and quite simple: the older the employee, the lower the rate of benefit accrual for that year even if two employees are otherwise being paid the same annual salary. In short, the pension plan treats younger employees more favorably than older ones precisely because they are younger.

ERISA forbids that result in defined-benefit plans. The statute provides that it constitutes unlawful age discrimination if "the rate of an employee's benefit accrual is reduced, because of the attainment of any age." 29 U.S.C. § 1054(b)(1)(H)(i). The Seventh Circuit reached the contrary result only by substituting its view of impermissible age discrimination for that supplied by Congress in ERISA. Concluding that the cause of the discriminatory treatment was merely the "time value of money" that

naturally inured to the benefit of those with more time until reaching normal retirement age (*i.e.*, those who are younger), Judge Easterbrook determined that Congress did not intend to prohibit it. App. 5-6. Thus persuaded, Judge Easterbrook was not deterred by the plain meaning of the actual statutory language, which does not include even the barest suggestion of the policy exception to age discrimination created by the court below.

Review by this Court is warranted not just because the lower court's ruling is legally erroneous, but also because Judge Easterbrook's reasoning conflicts with rulings of three other circuit courts and because of the ruling's extraordinarily far reaching implications. Literally millions of workers are subject to pension plans similar to that at issue in this case and the Seventh Circuit's misapplication of ERISA's nondiscrimination mandate threatens to deprive them of its essential protection.

A. The Seventh Circuit Ignored the Plain Meaning of ERISA's Test for Impermissible Age Discrimination.

The Seventh Circuit committed two distinct errors in reaching its conclusion that respondents' defined-benefit pension plan does not violate ERISA's prohibition of age discrimination. First, the court wrongly equated the economics of a defined benefit plan that uses a cash balance formula with a defined contribution plan. Second, the court inappropriately narrowed the congressional test for impermissible age discrimination applicable to defined benefit plans by misconstruing the term "employee's rate of benefit accrual" to mean the "employer's rate of contribution," which has an entirely different meaning and regulatory focus.

1. A Defined Benefit Plan Using a Cash Balance Formula Is Not Economically Equivalent to a Defined Contribution Plan.

The court of appeals found that IBM's cash balance formula was not age discriminatory by treating it as a defined contribution plan and applying the equal annual contribution test applicable to defined contribution plans. App. 1-5. Judge Easterbrook's opinion failed to recognize that ERISA's distinctly different rules prohibiting age discrimination in defined contribution and defined benefit plans follow from the fundamental economic differences between the two types of plans. Those basic differences are reflected in Congress's use of different definitions of "accrued benefit" in defined contribution and defined benefit plans. As *Hughes Aircraft* explained, "accrued benefit" in a defined contribution plan is simply "the balance of the individual's account." ERISA § 3(23)(B), 29 U.S.C. § 1002(23)(B). Consequently, age discrimination occurs in defined contribution plans if "the rate at which amounts are allocated to employee's account is . . . reduced, because of the attainment of any age." ERISA Section 204(b)(2)(A), 29 U.S.C. § 1054(b)((2)(A).

By contrast, in defined benefit plans the "employee's accrued benefit" is "expressed in the form of an annual benefit commencing at normal retirement age." ERISA § 3(23)(A), 29 U.S.C. § 1002(23)(A). Consequently, the test for age discrimination provided in ERISA Section 204(b)(1)(H)(i) is whether "the rate of an employee's benefit accrual is reduced, because of the attainment of any age." This test focuses on the amount of benefits the employee will receive beginning at normal retirement age, and there is no testing of "contributions" because there

are none to test. Hence the term "defined *benefit* plan": the employer makes no current contributions of funds to specific individual employee accounts, as would be the case under a defined contribution plan, but instead funds the pension plan on a group basis, makes the investment decisions, takes the investment risk, and is obligated to pay an amount of benefits at normal retirement age determined by a formula based on compensation and service years, not on the amount of the employer's funding of the plan. While cash balance plans are designed to superficially resemble defined contribution plans, it is well settled that they make the same promise to pay a specific benefit upon retirement in the same manner as any other defined benefit plan. Thus, they are governed by the same ERISA provisions as traditional defined benefit plans, *Esden*, 229 F.3d at 158, and as noted there are no "contributions" or "accounts" to test, only a formula that guarantees a retirement benefit.

Nevertheless, the Seventh Circuit treated IBM's cash balance plan as "economically equivalent" to a defined contribution plan and held that the "benefit accrual" in a cash balance plan can be tested in terms of an assumed, but not real, pay credit the employer "contributes" each year to the hypothetical cash balance account rather than the employee's actual entitlement under a cash balance formula, which is the "benefit under the plan commencing at normal retirement age." However, the fundamental differences between such plans – in terms of both investment risk and entitlement to investment gain – conclusively demonstrate that the Seventh Circuit is wrong. A defined benefit plan using a cash balance formula and a defined contribution plan are not "materially equivalent." Zelinsky Cooper Critique 23. In a defined benefit plan using a cash balance formula – completely unlike a defined contribution plan – "the employee covered by his

employer's cash balance plan, for better or worse, receives a fixed promise which shifts funding and investment risk to the employer." *Id.* at 21.

Having ignored the carefully crafted statutory differences between defined benefit and defined contribution plans, the Seventh Circuit expressly approved (App. 4-5) IBM's plan design that provides an annual accrual equal to 3% of salary for a 25-year-old participant which steadily declines with age to .4% of salary for an otherwise similarly situated 65-year-old. As IBM fully admitted (IBM 7th Cir. Reply Br. 14), a traditional defined benefit plan that provided such a declining rate of benefit accrual would violate ERISA Section 204(b)(1)(H)(i). Despite that admission, the Seventh Circuit excused IBM's cash balance formula – which provides precisely the same declining rate of benefit accrual as the admittedly discriminatory traditional plan – because those accrual rates purportedly result from compounding fictional interest credits to a fictional account. This exalts form over substance. If a traditional defined benefit plan cannot provide such a rate of benefit accrual, then a cash balance formula cannot be permitted to do so based on hypothetical "interest credits" "earned" on a non-existent account.

2. Judge Easterbrook's Opinion Misconstrued the Term "Employee's Rate of Benefit Accrual" To Mean "Employer's Rate of Contribution."

In addition to equating the cash balance formula to a defined contribution plan in economic terms, the Seventh Circuit held that "there is no statutory difference between the treatment of economically equivalent defined-benefit and defined-contribution plans." App. 5. The court purportedly found equivalence in the two standards of age discriminatio - ERISA § 204(b)(1)(H)(i) for defined

benefit plans and § 204(b)(2)(A) for defined contribution plans – by comparing them side-by-side. App. 3.

While Judge Easterbrook, without textual analysis, concluded that they "appear to say the same thing," (App. 3), the two standards are quite different because they reflect the fundamental differences between defined contribution and defined benefit plans. For defined benefit plans, including those using a cash balance formula, Section 204(b)(1)(H)(i) provides that "the rate of an employee's benefit accrual" cannot permissibly be "reduced, because of the attainment of any age." For defined contribution plans, Section 204(b)(2) provides that "the rate at which amounts are allocated to the employee's account" cannot permissibly be "reduced, because of the attainment of any age." Judge Easterbrook's opinion distorts the normal meanings of "allocate" and "benefit accrual." First, "[i]f these provisions say the same thing, why did the draftsmen write and Congress add to the [Internal Revenue] Code, ERISA and ADEA two different provisions addressing pension plan discrimination?" Zelinsky Cooper Critique 24. Professor Zelinsky points out that throughout ERISA, whenever a single rule applies to both defined benefit and defined contribution plans, only one statutory provision is provided. When separate policies apply to each type of plan, two statutory provisions are provided. *Id.* at 24-25. Here, Congress used strikingly different terms in each provision which follow from the fundamental differences in the two types of plan:

> [I]f the draftsmen who wrote the pension age discrimination statutes and the Congress which added them to the Code and ERISA meant to say "contribution," why instead did they say "benefit accrual?" More convincingly, "contribution" means "contribution" and "benefit accrual" pertains to the accrual of benefits under defined benefit plans. *Id.* at 26-27.

As Judge Baer in the Southern District of New York recently ruled in refusing to follow *Cooper*:

> The fact is accrual, using its dictionary meaning and in line with the structure of defined benefit plans, refers to what the employee accumulates (the outputs from the plan) whereas allocation, using its dictionary definition and in line with the structure of defined contribution plans, refers to what an employer puts into the account.

In re J.P. Morgan Chase Cash Balance Litigation, 2006 WL 2063424 at *9 (S.D.N.Y. Oct. 30, 2006).

Hence, Judge Easterbrook's use of the defined contribution standard for age discrimination to legitimize the declining rate of benefit accrual in cash balance plans is refuted both by the fundamental economic differences between such plans and the starkly different legal standards for age discrimination in defined benefit and defined contribution plans.[3]

Finally, the court's misconstruction of the meaning of "benefit accrual" prompted its further error in concluding that respondents' plan merely reflects the "time value of money" rather than impermissible age discrimination. In the striking absence of any statutory or case law

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[3] Indeed, Judge Easterbrook's reliance on hypothetical contributions to a non-existent account contradicts the IBM Plan's own description of the cash balance account:

> The Personal Pension Account shall be a recordkeeping account only, and neither the maintenance of, nor the crediting of amounts to, such Personal Pension Account shall be treated as an allocation of assets of the Plan, or a segregation of such assets in, any such Personal Pension Account. A Personal Pension Account shall not create any right for any person to receive specific assets of the Plan. CA App. 242, § 11.2(b).

authority,[4] the court asserted that the younger employees' higher benefit accrual rate compared to older employees with the same service and salary history should not be considered unlawful because it was justified by the longer time that younger employees wait to receive their benefits. App. 4-6.

But Judge Easterbrook's creation of a statutory exception because of the time value of money contradicts the express terms of Section 204(b)(1)(H)(i), which prohibits the reduction of "the rate of an employee's benefit accrual ... because of the attainment of any age." To establish a violation, this Section requires only that *any* employee's rate of benefit accrual decreases with age. It is indisputable that *every* participant in IBM's Plan will experience a reduction in the benefit accrual rate with increasing age. That is established by the table on page 9 above. Applying the "time value of money" does not change the mathematics of discriminatory benefit accrual.

[4] No doubt because of the absence of any applicable legal authority, the lower court ultimately resorted (App. 6-7) to a quotation from the preamble to proposed Treasury Department regulations that were *withdrawn* in response to an express Congressional mandate arising from concerns that the regulations might adversely impact the District Court's decision in this case. *See* Section 205, Consolidated Appropriations Act of 2004, P.L. 108-109. Judge Easterbrook somehow equates that preamble language as the legal equivalent of the views of the Treasury Department.

B. The Seventh Circuit's Decision Conflicts with Decisions of the Second, Ninth, and Eleventh Circuits.

The linchpin of Judge Easterbrook's opinion is his treating each employee's current cash balance account as the baseline for determining age discrimination in the rate of benefit accrual. Only by assuming the existence of actual annual contributions to an existing account balance could he eliminate from his legal analysis the future value of the "interest credits" that must be included in an employee's hypothetical account and therefore hold that the amount being "input" by IBM each year does not discriminate against older workers.

Every other court of appeals that has considered this issue has flatly rejected Judge Easterbrook's reasoning, which is essential to the Seventh Circuit's ruling. The Second Circuit in *Esden,* 229 F.3d at 162-164, the Ninth Circuit in *Miller v. Xerox Corp. Retirement Income Guarantee Plan*, 464 F.3d 871, 875-877 (9th Cir. 2006), and the Eleventh Circuit in *Lyons v. Georgia-Pacific Corp. Salaried Employees Ret. Plan*, 221 F.3d 1235, 1251-1252 (11th Cir. 2000), *cert. denied*, 532 U.S. 967 (2001), held that the current account balance must be ignored in analyzing defined benefit plans using the cash balance formula because that current account balance is purely hypothetical. An employee participating in a defined benefit plan using a cash balance formula is entitled, as in any defined benefit plan, to an accrued benefit at normal retirement age, and the measuring rod for violations of the employee's rights under ERISA is that accrued benefit, not a fictional account balance.

This conflict arises from a fundamental disagreement concerning the nature of an employee's accrued benefit in a defined benefit plan using a cash balance formula. In *Esden*, Judge Pierre Leval, writing for the Second Circuit,

held that "the accrued benefit under a defined benefit plan must be valued in terms of the annuity that it will yield at normal retirement age." 229 F.3d at 163. As a result, to determine an employee's accrued benefit in a cash balance plan, the current account balance must be projected to normal retirement age by adding the hypothetical "interest credits" for each year through normal retirement age. *Id.* at 165-166.

The Eleventh Circuit in *Lyons* addressed the same issue concerning the nature of the employee's accrued benefit in a cash balance plan and similarly held that the employee's accrued benefit was not the amount in his hypothetical account. 221 F.3d at 1251. Instead, for each year of service the employee "earned a vested interest in an amount at normal retirement age, to be calculated under the Plan by projecting forward the amount in his hypothetical account using the interest credit rates specified in the Plan." *Id.*

Judge Easterbrook flatly rejected these holdings: "Nothing in either ERISA or the IBM plan requires 40 years of interest to be credited to the account as soon as the younger worker earns wages." App. 8.

In *Esden*, Judge Leval not only described the "regulatory consequences" of the differing plan classifications as "wide reaching," but further singled out as primary consequences the differing definitions of "accrued benefit" applicable to each kind of plan and that "defined benefit plans are subject to a series of parallel statutory constraints . . . from which defined contribution plans are exempted." *Id.* at 158-59. And, in sharp contrast to the Seventh Circuit, the Second Circuit expressly recognized the legal significance under ERISA of the defining characteristic of a cash balance plan that justifies its regulatory treatment as a defined benefit plan: "the individual accounts, and the employer contributions and the interest credits to those accounts, are all hypothetical." *Id.* at 159, n.6. The Second Circuit, accordingly, rejected Judge

Easterbrook's central justification for the Seventh Circuit's ruling in this case, that the hypothetical nature of a cash balance plan could be assumed away and be treated under ERISA as the legal equivalent of a defined contribution plan with actual annual contributions.

The Ninth Circuit's decision in *Miller* likewise conflicts with the Seventh Circuit's ruling in this case. At issue in *Miller* was whether a procedure used by Xerox Corporation to reduce pension benefits at final retirement to account for earlier benefit distributions violated ERISA. In concluding that the pension plan violated ERISA, the Ninth Circuit, like the Second Circuit in *Esden* and the Eleventh Circuit in *Lyons*, accounted for ERISA's differing regulatory treatment of defined benefit and defined contribution plans, including the hypothetical nature of the employer's annual contributions. The Ninth Circuit specifically declined to analyze the validity of the pension plan at issue in *Miller* based on the plan operator's contention that it could fairly be equated to a defined contribution plan under which actual annual contributions were being made: "In short, Xerox may not use a projected-to-the-present value generated from a phantom account as a proxy for the actual distribution amount." *Id.* at 876.

Unlike the decision below, *Esden*, *Lyons*, and *Miller* did not decide an age discrimination claim under ERISA. But that distinction does not diminish or otherwise undermine the existence of a circuit conflict. Just the opposite. It both underscores the existence of a circuit conflict and magnifies its consequences. As *Esden*, *Lyons*, and *Miller* make clear, the legal consequences of the Seventh Circuit's error are not confined to ERISA age discrimination claims. A failure to respect ERISA's essential distinction between defined benefit plans and defined contribution plans, including defined benefit plans that purport to mimic features of a defined contribution plan, affects a wide range of regulatory consequences under

ERISA. ERISA's prohibition against age discrimination is just one example of those consequences.

Nor is there any room for doubt that the existing circuit conflict over the broader legal issue of the regulatory treatment under ERISA of defined benefit plans with cash balance formulas will inexorably lead to an even squarer circuit conflict in applying ERISA's nondiscrimination mandate. This conflict over the propriety of using the current account balance in a cash balance formula to define the participant's accrued benefit dictates whether a cash balance formula will be held to violate Section 204(b)(1)(H)(i). If the measuring rod is the employee's accrued benefit at normal retirement age, then it is indisputable that the employee's rate of benefit accrual under a cash balance formula declines with age in violation of Section 204(b)(1)(H)(i).

Indeed, the existing conflict in the circuits created by the Seventh Circuit ruling has already resulted in sharply differing district court decisions on the ERISA age discrimination issue, in just the few months since the Seventh Circuit's ruling. Two district courts in the Second Circuit recently rejected Judge Easterbrook's analysis and instead, following *Esden*, held that the cash balance account is irrelevant and therefore the cash balance formula violates Section 204(b)(1)(H)(i) because it results in a benefit accrual rate that decreases with age.[5]

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[5] *In re J.P. Morgan Chase Cash Balance Litigation*, 2006 WL 3063424 at *9 (S.D.N.Y. Oct. 30, 2006); *Richards v. FleetBoston Financial Corp.*, 2006 WL 3000768 at *3 (D. Conn. Oct. 16, 2006), refusing to reconsider its original ruling in favor of plaintiff, *Richards v. FleetBoston Financial Corp.*, 427 F. Supp. 2d 150 (D. Conn. 2006), in light of the Seventh Circuit's decision in this case. *But see Laurent v. PriceWaterhouseCoopers LLP*, 448 F. Supp. 2d 537, 2006 WL 2546805 at *11-15 (S.D.N.Y. Sept. 5, 2006) (adopting the Seventh Circuit's reasoning). There are at least three other active cases in which district courts

(Continued on following page)

Finally, the existence of the pending lower court age discrimination cases does not support this Court's awaiting their resolution on further appeal. The national stakes here are too high for this Court to wait until other circuits decide the specific Section 204(b)(1)(H)(i) issue presented by this case. The existing circuit conflict is not restricted to the age discrimination context, which is only one of many regulatory consequences affected, but instead simply underscored by it. And, apart from the obvious national interest in this Court's addressing the broad legal issue that is the subject of the existing circuit conflict, there are compelling equitable reasons raised just in this case that counsel against further delay. If this petition is denied, more than 250,000 IBM Plan participants will permanently lose their right to compensation in excess of $1 billion for unlawful age discrimination even if this Court ultimately determines, consistent with the reasoning of the Second, Eleventh, and Ninth Circuits, that the cash balance formula violates Section 204(b)(1)(H)(i). Participants in other plans will suffer the same permanent loss if their claims are rejected and they exhaust appellate review before this Court decides these issues.

The legal questions raised by the cash balance formula have been fully developed in this case, and no further refinement will be gained by delaying this Court's intervention. These issues are solely legal in nature and do not turn on factual matters. Thus there is no reason to suppose that a future case will provide this Court with a better or cleaner record than this one.

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rejected age discrimination claims against cash balance plans. *See Register v. PNC Fin. Servs. Group, Inc.*, 2005 WL 3120268 (E.D. Pa. Nov. 21, 2005), *appeal pending*, 3d Cir. No. 05-5445; *Hirt v. Equitable Retirement Plan*, 441 F. Supp. 2d 516 (S.D.N.Y. 2006); *Drutis v. Quebecor World (USA), Inc.*, 2006 U.S. Dist. LEXIS 84950 at *16-20 (E.D. Ky. Sept. 25, 2006), *appeal pending*, No. 06-6380 (6th Cir.).

C. The Legal Issues Presented by this Case Are Important.

The cash balance formula is currently used by many major American corporations to define what pensions their defined benefit plans will provide to over eight million workers. The proponents of cash balance plans have known since the formula's inception that it provides lower pension benefit accruals for older workers. Indeed, that is one of the formula's principal goals: to make the cost of providing older employees' pensions equal to the cost of providing pensions to younger workers by reducing the dollar value of the older worker's retirement annuity as compared to the dollar value of a younger worker's annuity. To mask this reduction, the cash balance formula pretends to be a 401k plan and attempts to focus the analysis away from the retirement annuity and onto a hypothetical "account balance." The issue in this case is whether the legal requirements ERISA imposes on defined benefit plans can be excused simply because the cash balance formula has superficial similarities to a 401k plan (which, as a defined contribution plan, is not subject to the same rules).

In the Pension Protection Act of 2006 ("PPA"), Congress refused to retroactively legitimize use of the cash balance formula and did so prospectively only with safeguards absent from the IBM Plan.[6] Consequently, the PPA

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[6] The PPA added protections for older employees when a plan converts to a cash balance format, including a shorter three-year vesting period, specifying the interest rate to be used to determine a participant's annuity at normal retirement age in the event of plan termination, and requiring that a participants' opening account balances be at least equal to their accrued benefits under existing plan at the date of conversion. P.L. 109-280, § 701. IBM's Plan does not satisfy all the new statutory requirements and therefore does not qualify prospectively as a valid cash balance plan.

did not affect the rights of millions of employees, including more than 250,000 in this case, to recover benefits lost because of age discrimination. Wholly apart from the prospective operation of the PPA, those interests are sufficiently great to warrant this Court's review, rather than allow for their resolution to turn on the happenstance whether the relevant employer falls within the jurisdiction of one federal circuit rather than another.

II. THE SIXTH AND SEVENTH CIRCUITS CONFLICT ON THE LEGALITY OF BENEFIT INCREASES PROVIDED ONLY TO YOUNGER EMPLOYEES.

The Seventh Circuit committed a second legal error as well. In a discussion limited to a single paragraph, the court (App. 12) dismissed petitioners' challenge to the Always Cash Balance Enhancement as a "rehash" of their contention that IBM's cash balance plan violated ERISA Section 204(b)(1)(H)(i). That is incorrect. In fact, the ACBE would unquestionably be illegal under the Seventh Circuit's "equal contribution" test: IBM made extra contributions to younger employees' opening account balances, while older employees' opening accounts were limited to their vested benefits under the prior plan. As a result of these unearned inputs, younger employees' retirement benefits instantly became larger than under the prior plan, while older worker's benefits remained unchanged. IBM's management was fully advised by the Plan's enrolled actuary of this discriminatory effect: "As you can see, the excess percentage of the ACB over the basic opening balance is directly related to age. Young employees get the benefit of the ACB and old participants do not." CA Supp. App. 88.

Judge Easterbrook's only legal justification for these age-based benefit differences is that "[a]n employer is free

to move from one legal plan to another legal plan, provided that it does not diminish vested interests – and this transition did not." App. 12. Without citing any supporting authority, the Seventh Circuit held that an employer, when changing plan designs, may increase only younger workers' benefits as long as older workers' vested benefits are not decreased.

This sweeping holding conflicts with the Sixth Circuit's decision in *EEOC v. Jefferson County Sheriff's Dept.*, 467 F.3d 571 (6th Cir. 2006) (*en banc*). The plan in that case provided that employees in hazardous positions disabled after age 55 or 20 years of service received their normal retirement benefits for which they were eligible at age 55 or after 20 years of service. However, disabled employees younger than 55 were credited with additional years of service to provide the benefits they would have received if they had worked to age 55 or reached 20 years of service. These terms resulted in some younger employees receiving greater benefits than older employees based on the same actual service and salary history. In adopting this plan for state and county employees, Kentucky did not take vested benefits away from the older workers, but the Sixth Circuit nevertheless ruled that the plan illegally discriminated against older employees. *Id.* at 579-580.

This Court should resolve this conflict by reversing the Seventh Circuit's approval of pension benefit increases limited to younger employees.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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NOVEMBER 28, 2006

Kathi COOPER, et al., on behalf of a class, Plaintiffs-Appellees,

v.

IBM PERSONAL PENSION PLAN and IBM CORPORATION, Defendants-Appellants.

No. 05-3588.

United States Court of Appeals, Seventh Circuit.

Argued Feb. 16, 2006.

Decided Aug. 7, 2006.

Rehearing and Rehearing En Banc Denied Sept. 1, 2006.*

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Jeffrey G. Huvelle (argued), Covington & Burling, Washington, DC, for Defendants-Appellants.

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Before BAUER, EASTERBROOK, and MANION, Circuit Judges.

EASTERBROOK, Circuit Judge.

The IBM Personal Pension Plan is a cash-balance defined-benefit plan. It is almost, but not quite, a defined-contribution plan. Although each employee in a

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* Circuit Judges Kenneth F. Ripple, Ilana Diamond Rovner and Ann Claire Williams took no part in the consideration of this matter.

defined-contribution plan has a fully funded individual account, the personal account in a cash-balance plan is not separately funded. Instead IBM imputes value to the account in the form of "credits": there are pay credits (set at 5% of the employee's gross taxable income) and interest credits (set at 100 basis points above the rate of interest on one-year Treasury bills). A trust holds assets that may (or may not) be enough to fund all of the individual accounts when workers quit or retire. IBM's plan permits an employee who quits or retires after working long enough for pension benefits to vest (a maximum of five years) to withdraw the balance in cash or roll it over into a fully funded annuity. During the time before cash-out the employee takes the risk that IBM will suffer business reverses and be unable to pay the full stated value of the account (if the amount already in trust for participants as a group turns out to be insufficient); otherwise IBM's plan is economically identical to a defined-contribution plan funded the same way and invested in a bond fund that returns 1% above the Treasury rate.

Plaintiffs in this class-action litigation contend that IBM's plan violates a subsection of ERISA (the Employee Retirement Income Security Act) that prohibits age discrimination. The district court ruled in plaintiffs' favor, see 274 F.Supp.2d 1010 (S.D.Ill.2003), and proceedings continued as the parties debated how much IBM owes (and how it must change its plan in future years) as a remedy. That subject has been resolved to mutual satisfaction – contingent on the district judge being right on the merits – so this appeal is limited to the question whether the plan is unlawfully discriminatory.

All terms of IBM's plan are age-neutral. Every covered employee receives the same 5% pay credit and the same

interest credit per annum. The basis of the plaintiffs' challenge – and the district court's holding – is that younger employees receive interest credits for more years. The language on which plaintiffs rely was added to ERISA in 1986; Congress also enacted a parallel provision covering defined-contribution plans. Pub.L. 99-509, 100 Stat. 1874, 1975, 1976 (1986). We set these out alongside to facilitate comparison:

Defined-benefit plans: ERISA § 204(b)(1)(H)(i), 29 U.S.C. § 1054(b)(1)(H)(i)	Defined-contribution plans: ERISA § 204(b)(2)(A), 29 U.S.C. § 1054(b)(2)(A)
[A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.	A defined contribution plan satisfies the requirements of this paragraph if, under the plan, allocations to the employee's account are not ceased, and the rate at which amounts are allocated to the employee's account is not reduced, because of the attainment of any age.

These appear to say the same thing, except that the rule for defined-benefit plans tells us what is not allowed, while the rule for defined-contribution plans tells us what works. Either way, the employer can't stop making allocations (or accruals) to the plan or change their rate on account of age. The IBM plan does neither of these things and therefore, one would suppose, complies with the statute. If this were a real, rather than a phantom, defined-contribution plan, that much would be taken for granted. Yet if the 5%-plus-interest formula is non-discriminatory when used in a

defined-contribution plan, why should it become unlawful because the account balances are book entries rather than cash?

Plaintiffs persuaded the district court, however, that the two subsections are radically different. That difference is attributable to the phrase "benefit accrual," which appears in the subsection for defined-benefit plans but not the one for defined-contribution plans. Neither ERISA nor any regulation defines this phrase, so the district judge went looking for some equivalent elsewhere in the statute. It found the phrase "accrued benefit," which is defined in § 3(23)(A), 29 U.S.C. § 1002(23)(A). An "accrued benefit" is an amount "expressed in the form of an annual benefit commencing at normal retirement age." Plug this back into § 204(b)(1)(H)(i), and the rule against discrimination then refers not to what IBM puts into the plan, but what the employee takes out on retirement. Someone who leaves IBM at age 50, after 20 years of service, will have a larger annual benefit at 65 than someone whose 20 years of service conclude with retirement at age 65. The former receives 15 years' more interest than the latter – and the judge assumed that this is not counterbalanced by the fact that older workers generally draw higher salaries. Under the district court's analysis, compound interest becomes a scourge, for the younger the employee when any given year's salary is earned, the greater the payout "expressed in the form of an annual benefit commencing at normal retirement age."

This approach treats the time value of money as age discrimination. Yet the statute does not require that equation. Interest is not treated as age discrimination for a defined-contribution plan, and the fact that these subsections are so close in both function and expression

implies that it should not be treated as discriminatory for a defined-benefit plan either. The phrase "benefit accrual" reads most naturally as a reference to what the employer puts in (either in absolute terms or as a rate of change), while the defined phrase "accrued benefit" refers to outputs after compounding. That's where this litigation went off the rails: a phrase dealing with inputs was misunderstood to refer to outputs. As long as we think of "benefit accrual" as referring to what the employer imputes to the account – an understanding reinforced by the use of the word "allocation" in the subsection addressing defined-contribution plans – there is no statutory difference between the treatment of economically equivalent defined-benefit and defined-contribution plans. For defined-benefit plans, where the account is an accounting entry rather than cash, "benefit accrual" matches the money "allocated" to a defined-contribution plan.

Nothing in the language or background of § 204(b)(1)(H)(i) suggests that Congress set out to legislate against the fact that younger workers have (statistically) more time left before retirement, and thus a greater opportunity to earn interest on each year's retirement savings. Treating the time value of money as a form of discrimination is not sensible. Cf. *Hazen Paper Co. v. Biggins*, 507 U.S. 604, 611, 113 S.Ct. 1701, 123 L.Ed.2d 338 (1993) (variables correlated with age must be kept "analytically distinct" from age when searching for discrimination). The parallel between the subsections for defined-benefit and defined-contribution plans shows as much. All sorts of things go wrong unless we treat both § 204(b)(1)(H)(i) and § 204(b)(2)(A) as addressing the rate at which value is added (or imputed) to an account, rather than the annual pension at retirement age. Consider a formula that adds

$500 to annual pension benefits for every year worked. This setup economically favors older workers (as does a top-five-year-salary multiplier) because it ignores the time value of money and treats the last year of work as contributing equally with the first. Yet on the plaintiffs' understanding it would be a form of discrimination against the old, because the $500 is a smaller "rate of benefit accrual" as time passes. Someone who worked two years would get a "100% rate of increase" in his second year (his annual benefits on retirement would jump from $500 to $1,000), while someone who works 20 years receives only a 2.56% increase (from $19,500 to $20,000) in Year 20.

Our conclusion that "benefit accrual" (for defined-benefit plans) and "allocation" (for defined-contribution plans) both refer to the employer's contribution rather than the time value of money between contribution and retirement has the support of regulations that the Treasury Department proposed. (Appropriations riders have prevented the Treasury from taking final action on the draft regulations, but they still help to inform our understanding of the statute.) The draft regulations treat the "rate of benefit accrual" as "the increase in the participant's accrued normal retirement benefit for the year." 67 Fed.Reg. 76123, 76125 (Dec. 11, 2002). For cash-balance plans in particular the phrase would have been defined as "the additions to the participant's hypothetical account for the plan year." 67 Fed.Reg. at 76126. The draft specifies that interest credits must accrue "at a reasonable rate of interest that does not decrease because of the attainment of age" and be provided "for all future periods, including after normal retirement age." *Ibid.*

Thus the Treasury's view, like our independent reading, looks at the rate of contribution (what goes into the

account) rather than the annual rate of withdrawal at retirement. The Treasury asks: "if this employee were younger, would the hypothetical balance have grown more this year?" For IBM's plan, the answer is no. When an employee is 20, his account is increased monthly by 5% of his salary plus credits based on the account's balance multiplied by a prescribed interest rate. The same is true when the employee turns 50, 60, or 70. Neither the contribution rate nor the interest rate changes with age. (No one contests the rate at which interest is credited – though 100 basis points over the Treasury rate looks low compared with what investments could earn in the private market and therefore could be understood to disfavor younger employees.)

Plaintiffs propose a different definition of "benefit accrual": annual pension (at retirement age) divided by salary. Contributions at age 25 produce an annual pension benefit that equals about 3% of each year's income in nominal dollars, while contributions at 65 produce annual benefits only 0.4% of the year's income. Not surprising, and hardly illuminating; this is just another illustration of the power of compound interest. The example depends on (a) allowing the pension to be increased by compounding, while (b) failing to discount the pension to present value. Stated another way, this example compares 1966 dollars (when the 25-year-old earned the salary) with 2006 dollars (when that person turns 65 and starts to draw a pension); of course the return on investment looks good, but much of it is inflation and the rest is real interest rates. The person who earns a salary in 2005 and retires in 2006 is (materially) unaffected by both inflation and compound interest. Nothing depends on age. Someone who earns a salary at age 65 and waits 40 years to start drawing a pension

would receive the same 3%-of-salary-per-retirement-year as the illustrative 25-year-old who retires at 65; and someone who earns wages at 25 and retires the next year gets the same 0.4%-of-salary annual pension, if not less (because of discounting).

Much of the plaintiffs' argument rests on the idea that the account of a 25-year-old worker does not get 5% plus periodic interest, but instead is immediately credited with 5% of salary plus 40 years' interest. That makes the contributions look discriminatory: the 25-year-old worker's account receives 40 times as much interest credit in the year the contributions accrue as a 65-year-old worker's account. Once again, however, this perspective misunderstands both the statute and the time value of money.

Nothing in either ERISA or the IBM plan requires 40 years of interest to be credited to the account as soon as the young worker earns wages. What plaintiffs have in mind is the rule that, when any beneficiary (young or old) elects to take a cash distribution or roll the account into an annuity before reaching age 65, the plan must distribute a lump sum calculated to be the "actuarial equivalent" of the annuity that would be available at normal retirement age. ERISA § 204(c)(3), 29 U.S.C. § 1054(c)(3). To derive the "actuarial equivalent" of a pension at age 65, a plan must (a) add all interest that would accrue through age 65, then (b) discount the resulting sum to its present value. *Berger v. Xerox Corp. Retirement Income Guarantee Plan*, 338 F.3d 755, 762-63 (7th Cir.2003). Plaintiffs characterize step (a) as extra interest credits for the young, but they ignore step (b). The discount rate may be close to (if it does not exceed) the rate at which interest is imputed, so the amount paid out in cash may be close to if not below the nominal balance in the account. *Berger* did not consider

§ 204(b)(1)(H)(i) and does not hold that the process of grossing up the balance and then discounting is a form of age discrimination. To the contrary: *Berger* described this process as the means to *avoid* age discrimination.

As far as we can see, ours is the first appellate decision to address the status of cash-balance plans under § 204(b)(1)(H)(i). The class directs our attention to two decisions from other circuits that it says supply helpful analysis. *Miller v. Xerox Corp. Retirement Income Guarantee Plan*, 447 F.3d 728 (9th Cir.2006); *Esden v. Bank of Boston*, 229 F.3d 154 (2d Cir.2000). As the class reads them, these opinions stand for two important propositions. First, that an "accrued benefit" in a cash-balance plan is an annuity at normal retirement age. Second, that there is a "fundamental" distinction between defined-contribution and defined-benefit plans. Both of these propositions are correct, and both of them are irrelevant.

Start with the first proposition. What the true meaning of "accrued benefit" may be is not controlling; § 204(b)(1)(H)(i) does not use that phrase, and we have explained why "benefit accrual" means something other than "accrued benefit." Once we start to calculate accrued benefits for people who quit or retire early, it is necessary to impute extra interest and discount. *Berger* describes how this is done. But "benefit accrual" refers to the annual addition to the pot, not to the final payout. The holding of *Esden*, see 229 F.3d at 168, mirrors that of *Berger* and requires no further comment. *Miller* extends the framework of *Esden* and *Berger* to evaluate reductions in notional account balances caused by previous lump-sum distributions. 447 F.3d at 733-34. See 26 C.F.R. § 1.411(a)-7(d)(6) (offset may equal the "accrued benefit attributable to the distribution").

As for the second proposition, plaintiffs cite language describing the regulatory framework as "rigidly binary" (*Esden*, 229 F.3d 154, 159 n. 6). True enough. A defined-contribution plan entails fully funded individual accounts; everything else is a defined-benefit plan. 29 U.S.C. § 1002(25). *Miller* adds that "interest credits are defined benefit entitlements ... and are not analogous to the investment growth of a defined contribution plan." 447 F.3d at 735. Maybe so; that depends on what the court meant by "analogous." Interest in a defined-contribution plan is real, while interest credits in a defined-benefit plan are bookkeeping entries (effectively debt obligations of the employer to the extent that the pension trust fund does not cover them). But so what? IBM does not contend that its plan is governed *by* § 204(b)(2)(A), just that § 204(b)(1)(H)(i) does not whimsically require a court to find age discrimination for a defined-benefit plan when materially identical statutory language allows functionally identical defined-contribution plans to operate without any taint of discrimination. To say that defined-benefit and defined-contribution plans are governed by different subsections of ERISA is not to say that what is lawful for one must be forbidden to the other. We conclude that § 204(b)(1)(H)(i) and § 204(b)(2)(A) indeed provide similar treatment with respect to claims of age discrimination.

Only a brief mention of *Arizona v. Norris*, 463 U.S. 1073, 103 S.Ct. 3492, 77 L.Ed.2d 1236 (1983), another mainstay of the class's briefs, is called for. In *Norris* women making the same pension contributions as men, all else held equal, had lower annual pension benefits. *Id.* at 1082, 103 S.Ct. 3492. Under IBM's plan any differences in pension benefits are a function of differing years of service,

salary history, or the years the balance has been allowed to compound; age is not a factor.

Here, as so often, it is essential to separate age *discrimination* from other characteristics that may be correlated with age. That was the Supreme Court's point in *Hazen Paper*: wages rise with seniority (and thus with age) at many employers, but distinctions based on wage levels (in order to reduce a payroll) do not "discriminate" by age. See also, e.g., *Achor v. Riverside Golf Club*, 117 F.3d 339, 341 (7th Cir.1997) (need to show "the effect of age, isolated from other influences"); *Sheehan v. Daily Racing Form, Inc.*, 104 F.3d 940, 942 (7th Cir.1997) (expert should correct for "potentially explanatory variables other than age" when determining whether discrimination was because of age). While those decisions involved different statutory regimes, the objective is general: a plaintiff alleging age discrimination must demonstrate that the complained-of effect is *actually* on account of age. One need only look at IBM's formula to rule out a violation. It is age-neutral.

Now this may give a clue about why plaintiffs (a class of older workers) have sued. The cash-balance plan replaced a more traditional arrangement under which the annual pension on retirement was a function of closing salary (say, an average of the last five years before retirement) multiplied by the number of years of service. Because wages rise with seniority, such a formula favors older workers. Workers who quit or retire early not only miss out on the rising wages that accompany seniority but also don't receive credit for the time value of money: years of service at age 30 and at age 70 count equally in the traditional formula. Many employers design such back-loaded systems to give the most-experienced members of

the labor force a reason (even beyond rising salary) to stay on the job. Like a defined-contribution plan, a cash-balance plan removes the back-loading of the pension formula; older workers (accurately) perceive that they are worse off under a cash-balance approach than under a traditional years-of-service-times-final-salary plan. But removing a feature that gave extra benefits to the old differs from discriminating against them. Replacing a plan that discriminates against the young with one that is age-neutral does not discriminate against the old.

There is a transition issue. When IBM moved employees from a more traditional plan to a cash-balance system, it gave them the greater of the present value of their pension entitlements as of the transition date or the account balance that they would have had if IBM had a cash-balance plan in effect since the employee came to work. Plaintiffs complain that this gives the younger workers too much credit for interest (because more time passes between their work and retirement dates), but that rehashes arguments that we've already rejected. Every employee with the same salary and service record receives the same opening account balance under the new plan. That the change disappointed expectations is not material. An employer is free to move from one legal plan to another legal plan, provided that it does not diminish vested interests – and this transition did not. Cf. *Lockheed Corp. v. Spink*, 517 U.S. 882, 116 S.Ct. 1783, 135 L.Ed.2d 153 (1996) (employers are not fiduciaries under ERISA when they create or amend pension plans).

Litigation cannot compel an employer to make plans more attractive (employers can achieve equality more cheaply by reducing the highest benefits than by increasing the lower ones). It is possible, though, for litigation

about pension plans to make everyone worse off. After the district court's decision IBM eliminated the cash-balance option for new workers and confined them to pure defined-contribution plans. See Ellen E. Schultz & Theo Francis, *How Safe Is Your Pension? – Freeze of IBM Plan Leaves Workers Worrying If Their Employer Is Next*, Wall St. J., Jan. 12, 2006, at D1; Ellen E. Schultz, *IBM to Exclude New Workers From Its Cash-Balance Pension – Move to Only 401(k) Plans Follows Legal Questions*, Wall St. J., Dec. 9, 2004, at A2. Whether that is good or bad (for employees or society as a whole) is not for us to say. What we can and do conclude, however, is that the decision may again be made freely, governed by private choice rather than legal constraint.

The judgment of the district court is reversed, and the case is remanded with directions to enter judgment in IBM's favor.

Kathi COOPER, Beth Harrington, and Matthew Hillesheim, Individually and on Behalf of All Those Similarly Situated, Plaintiffs,

v.

The IBM PERSONAL PENSION PLAN and IBM Corporation, Defendants.

No. CIV. 99-829-GPM.

United States District Court,
S.D. Illinois.

July 31, 2003.

Steven A. Katz, Douglas R. Sprong, Korein Tillery, Swansea, IL, Robert F. Hill, John H. Evans, Hill & Robbins, William K. Carr, Law Offices of William K. Carr, Denver, CO, for Plaintiffs.

Jeffrey G. Huvelle, Robert D. Wick, Covington & Burling, Washington, DC, Frederick J. Hess, Lewis, Rice et al., Belleville, IL, for Defendants.

MEMORANDUM AND ORDER

MURPHY, Chief Judge:

The Cooper class challenges IBM's pension plan ("Plan") as violative of the age discrimination prohibitions of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §§ 1001-1461. All pending motions are listed in the appendix to this Memorandum and Order. (*See* Appendix A.)

I. *Factual Background*

Plaintiff Cooper has been a Plan participant since May 21, 1979, the day she began her employment with IBM. Plaintiff Harrington was a Plan participant from 1990 to August 2000, when she terminated her employment with IBM. Towards the end of Harrington's employment, her pension benefits accrued pursuant to a Plan amendment made effective July 1, 1999. Plaintiff Hillesheim began employment with IBM in 1996 and terminated his employment in March 2000. He is a Plan participant, but because he was employed for fewer than five years, the benefits he accrued under the Plan did not vest.

IBM Plan Amendments

The IBM Plan is a defined benefit pension plan[1] that provides benefits for IBM employees. Since 1995, the Plan has been amended twice. The changes created by these amendments are the basis of Plaintiffs' lawsuit.

A. *The January 1, 1995 Amendment*

Before 1995, the IBM Plan provided benefits in the form of a lifetime annuity and a cash balance accumulation. On January 1, 1995, IBM's Board of Directors enacted an amendment to the Plan which adopted a plan

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[1] Under a conventional defined benefit plan, an employee is credited with a specific percentage of his or her salary for each year of employment. *See Esden v. Bank of Boston*, 229 F.3d 154, 158 n. 4 (2nd Cir.2000). This differs from a defined contribution plan in which funds are actually deposited into an employee's account.

design known as a pension equity plan. IBM coined its new design the Pension Credit Formula ("PCF").

PCF participants accrue a normal retirement benefit payable in the form of a life annuity commencing at age 65. Each year, a participant earns a specific number of "base points," which is determined by the employee's age in the year worked. Additionally, a participant can earn "excess points" if his or her five year average earnings are above social security compensation. Under this framework, however, a participant is permitted to accumulate no more than 425 base points and 75 excess points.

A participant's base points and excess points are applied to a five step formula to determine the monthly retirement benefit at age 65. Under this formula, a participant's base points are added, divided by 100, and multiplied by the average of his or her highest consecutive five year earnings. Then, after accounting for the participant's excess points, that number is divided by a "benefit conversion factor."

The class claims that the PCF violates ERISA because it is age discriminatory. This claim is based on the PCF's benefit conversion factor which increases in direct correlation to an employee's age. According to the class, this increase causes an older employee to receive a lower rate of benefit accrual and to have a smaller accrued benefit at age 65 than a younger employee, despite having worked the same number of years at the same salary as the younger employee.

B. *The July 1, 1999 Amendment*

Effective July 1, 1999, IBM again amended its Plan to create its Cash Balance Formula ("CBF"). Under the CBF, a participant's benefit is determined by reference to a hypothetical account known as a Personal Pension Account ("PPA"). Every month, a participant's PPA accumulates "pay credits" at a rate of 5% of the employee's salary and "interest credits" at a rate one percentage point higher than the rate of return on one year treasury securities. When a participant's employment with IBM ends, he may withdraw his account balance as a lump sum, convert the account balance into an immediate life annuity, or defer the receipt of a lump sum payment or a life annuity until a later date. While a former employee is unable to earn additional pay credits, he continues to accumulate interest credits until his PPA balance is withdrawn or converted into a life annuity.

The class alleges that the CBF also violates ERISA's laws against age discrimination. This claim is based on how interest credits accrue on a participant's PPA balance until he reaches normal retirement age.

II. *Standard of Review*

All but one of the motions before the Court are motions for summary judgment. The standard applied to summary judgment motions filed under Federal Rule of Civil Procedure 56 is well-settled and has been succinctly stated as follows:

> Summary judgment is proper when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to

> any material fact and that the moving party is entitled to a judgment as a matter of law. In determining whether a genuine issue of material fact exists, [the court] must view the record in a light most favorable to the nonmoving party. Because the primary purpose of summary judgment is to isolate and dispose of factually unsupported claims, the nonmovant may not rest on the pleadings but must respond, with affidavits or otherwise, setting forth specific facts showing that there is a genuine issue for trial. The evidence must create more than some metaphysical doubt as to the material facts. A mere scintilla of evidence in support of the nonmovant's position is insufficient; a party will be successful in opposing summary judgment only when it presents definite, competent evidence to rebut the motion.

Albiero v. City of Kankakee, 246 F.3d 927, 931-32 (7th Cir.2001) (internal citations and quotations omitted).

III. *Analysis*

The Court's analysis will be divided into two sections: (1) all motions related to IBM's 1995 Pension Credit Formula; and (2) all motions related to IBM's 1999 Cash Balance Formula.

1995 Pension Credit Formula

The class alleges that the terms of the IBM Plan, as amended January 1, 1995, violate ERISA § 204(b)(1)(G) & (H). Specifically, the class claims that under the PCF, benefits are reduced on account of *increases in age or service* in violation of § 204(b)(1)(G) and that the benefits accrue at a *rate which is reduced because of age or the*

attainment of any age in violation of § 204(b)(1)(H). The class seeks to have Plan benefits determined in a manner consistent with these ERISA provisions and to enjoin IBM from continuing these violations.

Defendants move to dismiss the § 204(b)(1)(H) claim on the grounds that the ERISA age discrimination provisions apply only to employees who have reached normal retirement age (age 65), arguing that the younger Plaintiffs lack standing to sue. Defendants are wrong.

ERISA § 502(a) provides that "[a] civil action may be brought . . . (3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provision of this subchapter or the terms of the plan." 29 U.S.C. § 1132(a). The plain language of this provision confers statutory standing to plan participants, such as the named Plaintiffs, who seek to protect their employee benefit rights. Because Congress is entitled to enact statutes which create standing where it would otherwise not exist, *see Village of Bellwood v. Dwivedi,* 895 F.2d 1521, 1526 (7th Cir.1990), Defendants' motion to dismiss (Doc. 103) is denied.

A. *§ 204(b)(1)(G) Claim*

Cooper filed a motion for partial summary judgment (Doc. 87) on July 18, 2002, seeking, in part, a determination that the PCF violates the age discrimination provision of ERISA § 204(b)(1)(G) because the amount of an employee's accrued benefit under the Plan decreases on account of the employee's age. Defendants have likewise filed a motion for summary judgment on the § 204(b)(1)(G)

claim, arguing that no participant in the IBM Plan has ever experienced a reduction in his or her accrued benefit on account of an increase in age or service and, therefore, the named Plaintiffs lack standing to assert this claim.

Section 204(b)(1)(G) has been part of ERISA since its inception in 1974 and provides that "a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if the participant's accrued benefit is reduced on account of any increase in his age or service." 29 U.S.C. § 1054(b)(1)(G). In the context of a defined benefit plan, such as the IBM Plan, the term "accrued benefit" means "'the individual's accrued benefit determined under the plan and . . . *expressed in the form of an annual benefit commencing at normal retirement age.*'" 29 U.S.C. § 1002(23)(A). "Normal retirement age" is 65. *See* 29 U.S.C. § 1002(24); *see also Esden v. Bank of Boston*, 229 F.3d 154, 162 (2nd Cir.2000).

The PCF adopted by IBM in the January 1, 1995, amendment to its Plan violates ERISA. The following examples illustrate the violation.

A participant's retirement benefit is computed under the PCF by a five step formula: (1) the total number of base points earned at that time, up to a maximum of 425, are added and then divided by 100; (2) the number from the first step is multiplied by the average of the employee's highest consecutive five year earnings to determine what the Plan denominates as the "Base Point Benefit Value at Normal Retirement Age;" (3) if the employee's five year average earnings exceed social security compensation, the excess points earned are similarly added, up to a maximum of 75, divided by 100, and then multiplied by the dollar amount by which the employee's five year average

exceeds social security compensation, to determine the employee's "Excess Point Benefit Value at Normal Retirement Age;" (4) the employee's Base Point Benefit Value at Normal Retirement Age and any Excess Point Benefit Value at Normal Retirement Age are added together to yield the employee's "Pension Credit Value at Normal Retirement Age;" and (5) this Pension Credit Value is then divided by a "Benefit Conversion Factor" specified in the Plan. The result is the dollar amount of the employee's annual annuity commencing at age 65, which can be divided by twelve to determine the monthly annuity.

Suppose an employee begins working for IBM at age 35 and earns an annual salary of $60,000.00 until his employment ends at age 50. During this fifteen year period, he will accumulate 215 base points. *See* App. B. After dividing by 100, and multiplying by $60,000.00, the employee is assigned a "Base Point Benefit Value at Normal Retirement Age" of $129,000.00. Because termination occurs when this employee is 50 years old, his benefit conversion factor (which is divided into his $129,000.00 base point value) is 8.537. *See* App. C. Therefore, his age 65 accrued benefit is equal to **$15,110.69 per year or $1,259.22 per month**.

Now, change only the age – our hypothetical employee starts his employment with IBM at age 50 instead of age 35. This employee will accumulate more base points than his younger counterpart; a total of 240. *See* App. B. After dividing by 100, and multiplying by $60,000.00, he is assigned a higher "Base Point Benefit Value at Normal Retirement Age" of $144,000.00. However, this 65 year old employee is also assigned a higher benefit conversion factor equal to 10.918. *See* App. C. After his $144,000.00 base point value is reduced by this conversion factor, he is

left with an age 65 accrued benefit equal to only **$13,189.23 per year or $1,099.10 per month.**

Finally, consider an employee who begins working at age 25 and earns $60,000.00 each year until he retires at age 65. By age 58, this employee has 423 base points and a benefit conversion factor of 10.543. *See* Apps. B & C. Applying the PCF's five step analysis, he has an age 65 accrued benefit of **$24,072.84 per year or $2,006.07 per month**. For an additional year of service, this same employee will receive only two (as opposed to sixteen) base points because he will have reached the 425 point cap. Notwithstanding, the employee's benefit conversion factor continues to rise to 10.596. *See* App. C. After applying the IBM formula, his age 65 accrued benefit has *decreased* to **$24,065.69 or $2,005.47 per month**. Each additional year he works, this employee will accumulate zero base points because of the cap. Still, as his years of service continue to increase, so does the benefit conversion factor. By age 65, this employee's benefit conversion factor will be 10.918. *See* App. C. Under the PCF, this will yield an accrued benefit of only **$23,355.93 or $1,946.00 per month**.

The benefit conversion factor contained in the PCF reduces a participant's accrued benefit solely on increases in age or service. Accordingly, the 1995 PCF violates ERISA § 204(b)(1)(G). *See* 29 U.S.C. § 1054(b)(1)(G). Defendants' argument that no specific employee has actually suffered a reduction in his or her accrued benefit is rejected because it relates to damages as opposed to liability and because Congress has conferred statutory standing to all "participants" in an ERISA plan. *See* 29 U.S.C. § 1132(a)(3). Plaintiffs' motion for partial summary judgment on Count

I (Doc. 87) is granted, and Defendants' motion for partial summary judgment on Count I (Doc. 105) is denied.

B. *§ 204(b)(1)(H)*

Cooper's motion for partial summary judgment on Count I also seeks a determination that the PCF in the 1995 IBM Plan violates ERISA § 204(b)(1)(H) because the rate of an employee's benefit accrual under the Plan decreases on account of the employee's age. Defendants have also filed a motion for summary judgment on the § 204(b)(1)(H) claim.

Section 204(b)(1)(H) was enacted as part of the Omnibus Budget Reduction Act of 1986 and provides that "a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age." 29 U.S.C. § 1054(b)(1)(H).

Under the PCF, the rate of accrual of an employee's *immediately-payable* benefit steadily increases with age. However, the PCF can result in a decrease in the rate at which an employee's *age 65 annuity* accrues. Therefore, it is important whether § 204(b)(1)(H)'s term "rate of benefit accrual" refers to the rate at which an employee accrues a benefit payable in the form of an annuity that commences at age 65, or if an employee's "rate of benefit accrual" may be measured by reference to an immediate annuity.

ERISA does not explicitly answer this question. However, the term "accrued benefit" which appears in § 204(b)(1)(G) refers to an employee's accrued benefit "expressed in the form of an annual benefit commencing at

normal retirement age." *See* 29 U.S.C. § 1002(23)(A); *see also Esden,* 229 F.3d at 163. Defendants argue that § 204(b)(1)(H)'s phrase "rate of benefit accrual" should not be expressed in the form of an age 65 benefit and that the term *benefit accrual* means something different than the term *accrued benefit.*

This argument is based on the actuarial premise "time value of money." According to Defendants, it is economically nonsensical to compare a 25 year old employee's rate of benefit accrual with a 64 year old employee's rate of benefit accrual by reference to the age 65 benefit that each has accumulated, because the 64 year old employee is set to receive his benefit much sooner. Accordingly, § 204(b)(1)(H)'s phrase "rate of benefit accrual" should be interpreted to refer to benefits payable immediately upon termination of employment.

From an economist's perspective, Defendants have a good argument. A dollar today is worth more than the promise of a dollar a year from now. This does not mean, however, that the PCF is legal.

ERISA creates specific rules relating to defined benefit plans. It is clear that a participant's accrued benefit, as it appears in § 204(b)(1)(G), must be measured by reference to the amount of an employee's annual benefit at age 65. *See* 29 U.S.C. § 1002(23)(A); *see also Esden,* 229 F.3d at 163. The language at issue – "rate of benefit accrual" – is found in the very next subchapter, § 204(b)(1)(H). The best interpretation of this phrase is that it also refers to an employee's age 65 annual benefit and the rate at which that age 65 annual benefit accrues.

Defendants question why Congress would use different language in succeeding subparagraphs (accrued

benefit and benefit accrual) unless it intended the subparagraphs to cover different types of benefits. The answer is simple. Congress chose to be grammatically correct. The term accrued benefit in § 204(b)(1)(G) means an employee's age 65 *accumulated benefit.* If Congress had used the term accumulated benefit in § 204(b)(1)(G), instead of the term accrued benefit, it would not have used the clumsy phrase "rate of accumulated benefit" in § 204(b)(1)(H). Presumably, Congress would have opted for standard English and used the phrase "rate of benefit accumulation," even though it intended to cover the same type of benefit in both subparagraphs.[2]

Congress intended § 204(b)(1)(H) to cover the rate at which a participant's age 65 benefit accrues under a defined benefit plan. So, is the rate of a participant's benefit accrual under the PCF reduced because of the participant's age? The answer is yes, as illustrated by the previous hypotheticals.

A participant who works at IBM from age 35 to age 50 earning a salary of $60,000.00 will accrue an age 65 annual benefit under the PCF of **$15,110.69**. On the other hand, an employee who works for IBM from age 50 to age 65, also earning an annual salary of $60,000.00, will accrue an age 65 annual benefit under the PCF of only **$13,189.23**. To determine the "rate of benefit accrual" for these hypothetical employees, their age 65 annuity is divided by the product of their average compensation

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[2] For a simpler example, consider the word popcorn. Popcorn is the word used to describe the product created by exposing corn kernels to extreme heat. If asked to draft a phrase related to the speed of this process, one would not say "rate of popcorn." Rather, to be grammatically correct, one would say "the rate corn pops."

($60,000.00) and years of service (15). *See* Doc. 88, App. C, p. 11. Thus, the 50 year old employee accrues an age 65 annual benefit at a rate of **1.68%**.[3] In contrast, the 65 year old employee accrues an age 65 annual benefit at a rate of only **1.47%**.[4]

The decrease in rate of age 65 annual benefit accrual is also demonstrated by reference to the sharp yearly reduction in percentage that occurs to employees who have reached the 425 base point cap under the PCF. As previously noted, an employee who begins working for IBM at age 25 will reach the 425 base point maximum between ages 58 and 59. At age 59, after 35 years of service, he has accrued an age 65 annual benefit of $24,065.69 [5] under the PCF. Therefore, his rate of benefit accrual is **1.15%**.[6] At age 60, with an annual benefit of $23,945.91, his rate of benefit accrual drops to **1.11%**.[7] This employee's rate of benefit accrual continues to decrease each year, leaving him with a rate of **0.95%**[8] by age 65.

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[3] $15,110.68/($60,000.00 x 15).

[4] $13,189.23/($60,000.00 x 15).

[5] This employee has accumulated 425 base points and has a benefit conversion factor of 10.596. See Apps. B and C. Because his highest five year average salary is $60,000.00, the PCF would be applied as follows:

(425/100) = 4.25 x $60,000.00 = $255,000.00/10.596 = $24,065.69
4.25 $255,000.00

[6] Again, rate of benefit accrual is calculated by dividing an employee's age 65 annual benefit by (years of service x average compensation):

$24,065.69/(35 x $60,000.00) or
$24,065.69/($2,100,000.00) = 1.15%

[7] $23,945.91/(36 x $60,000.00) or
$23,945.91/($2,160,000.00) = 1.11%

[8] $23,355.93/(41 x $60,000.00) or
$23,355.93/(2,460,000.00) = 0.95%

These examples illustrate that under the PCF, a participant's rate of benefit accrual decreases because of the attainment of a certain age. For this reason, the PCF violates ERISA § 204(b)(1)(H). Plaintiffs' motion for partial summary judgment on Count I (Doc. 87) is granted, and Defendants' motion for partial summary judgment on Count I (Doc. 130) is denied.

C. *§ 204(b)(1)(A)(B) & (C) (Anti-backloading)*

The class also claims that, effective January 1, 1995, benefits accruing under the terms of the IBM Plan do not satisfy any of the three "anti-backloading" rules found in subparagraphs (A), (B), or (C) of ERISA § 204(b)(1). *See* 29 U.S.C. § 1054(b)(1). Defendants seek summary judgment on this claim. Defendants cannot comply with either the 3% rule or the 133 1/3% rule and must comply with the anti-backloading rules, if at all, by satisfying the fractional rule of § 204(b)(a)(C).

The issue is whether the Plan's PCF satisfies subparagraph (C) during its "phase-in" period from January 1, 1995 (the date of the PCF's enactment) to December 31, 1999.

ERISA § 204(b)(1)(C) states:

> [a] defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which any participant is entitled upon his separation from the service is not less than a fraction of the annual benefit commencing at normal retirement age to which he would be entitled under the plan as in effect on the date of his separation if he continued to earn annually until normal retirement age the same rate of compensation upon

> which his normal retirement benefit would be computed under the plan, determined as if he had attained normal retirement age on the date any such determination is made (but taking into account no more than the 10 years of service immediately preceding his separation from service). Such fraction shall be a fraction, not exceeding 1, the numerator of which is the total number of his years of participation in the plan (as of the date of his separation from the service) and the denominator of which is the total number of years he would have participated in the plan if he separated from the service at the normal retirement age. For purposes of this subparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

29 U.S.C. § 1054(b)(1)(C).

A 40 year old employee starts working for IBM on January 1, 1995, with an annual salary of $60,000.00 and quits one year later. His accrued annual benefit is **$311.80.**[9] To satisfy § 204(b)(1)(C), his "fractional rule

---

[9] Under the terms of the IBM Plan, the PCF uses compensation averaged over a five year period. However, compensation earned before 1995 cannot be used in this average. Therefore, from January 1, 1995, to December 31, 1999, a participant's average compensation is determined by adding together his total compensation and dividing by five. In the hypothetical above, the employee earning $60,000.00 per year has an average compensation of only $12,000.00 after his first year of service. The employee accumulated 15 base points and has a conversion factor of 5.773. *See* Apps. B & C. Using these figures, the analysis under the PCF is as follows:

(15/100) = .15	.15 x $12,000.00 = $1,800.00	$1,800.00/5.773 =	$311.80

benefit" (the age 65 annual accrued benefit to which he would be entitled under the PCF if he continued to earn $60,000.00 annually until he attained age 65, multiplied by the applicable fraction) must be less than or equal to $311.80. His annual accrued benefit is **$21,707.27**[10] if he continues working until age 65. The fraction used to reduce this amount is **1/25.**[11] Thus, his fractional rule benefit is **$868.29,**[12] an amount greater than the benefit accrued on the date he stopped working for IBM. This violation continues until the fourth year (1998) of the PCF's "phase-in" period.[13]

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[10] This employee would accumulate 395 base points and would have a conversion factor of 10.918 if he continues working until age 65. *See* Apps B and C. Because under § 204(b)(1)(C) it is presumed that he continues earning $60,000.00 until age 65, the PCF would be applied as follows:

$$(395/100) = \frac{3.95}{3.95} \times \$60{,}000.00 = \$237{,}000.00 \qquad \$237{,}000.00/10.918 = \underline{\$21{,}707.27}$$

[11] $$\frac{\text{Total \# of years of participation in the plan (as of date of separation from service)}}{\text{Total \# of years he would have participated in the plan if he separated from the service at the normal retirement age.}}$$

[12] $21,707.27 x (1/25) = $868.29.

[13]

1996:	Benefit on date of separation	= $1,187.73	[(30/100 x $24,000.00)/6.062]
	Fractional rule benefit	= $1,736.58	($21,707.27 x 2/25)
1997:	Benefit on date of separation	= $2,545.17	[(45/100 x $36,000.00)/6.365]
	Fractional rule benefit	= $2,604.87	(21,707.27 x 3/25)
1998:	Benefit on date of separation	= $4,309.44	[(60/100 x $48,000.00)/6.683]
	Fractional rule benefit	= $3,473.12	(21,707.27 x 4/25)

But Defendants argue that § 204(b)(1)(C)'s language "as if he had attained normal retirement age on the date any such determination is made" should be interpreted to mean that the fractional rule benefit should be calculated as though the employee turned age 65 on the date his service ended. This is wrong.[14] Section 204(b)(1)(C) provides that the fractional rule benefit is the "annual benefit commencing at normal retirement age to which [an employee] would be entitled ... if he *continued to earn annually until normal retirement age* the same rate of compensation upon which his normal retirement benefit would be computed under the plan." (emphasis added). The words *continued to earn annually until normal retirement age* means that the employee's benefit must be calculated as though he remained employed until age 65.

Moreover, if Defendants' interpretation is correct, § 204(b)(1)(C) is rendered meaningless. The 40 year old hypothetical employee used in the last example would have a fractional rule benefit of **$7.03**[15] at the end of his

---

[14] For the reasons that follow in the text of this Order, § 204(b)(1)(C), when read as a whole, does not call for a fractional rule benefit calculated as though an employee turned age 65 on the date his service ended. The Court reads the phrase "as if he had attained normal retirement age on the date any such determination is made" as referring solely to an employee's rate of compensation, and is included to ensure that the salary that an employee is earning when his service ends is used as the employee's salary at age 65 when his fractional rule benefit is determined.

[15] If the employee retired in 1996, after working only one year, he would be treated as having turned age 65 in 1996 for fractional rule purposes if Defendants have correctly interpreted § 204(b)(1)(G). Therefore, he would have accumulated 16 base points during this year of employment and would have a conversion factor of 10.918 under the PCF. *See* Apps. B and C. Thus, his fractional rule benefit would be calculated as follows:

(Continued on following page)

first year of employment as Defendants apply the statute. Congress did not intend § 204(b)(1)(C) to invalidate only those plans that produce less than $7.03 in pension benefits for a 40 year old employee earning $60,000.00.

Defendants argue that it is unfair to compare a partially phased in benefit with a fully phased in fractional rule benefit. But this is exactly the situation that § 204 is intended to cover. *See Jones v. UOP,* 16 F.3d 141, 144-45 (7th Cir.1999). The PCF directs that a first year participant's salary be divided by five and accordingly that participant's benefits are "backloaded," *i.e.,* five years of employment are required before the participant can ratably accrue pension benefits. Defendants' motion for summary judgment on the § 204(b)(1)(C) claim (Doc. 128) is denied.

(16/100) = .16 .16 x $12,000.00 = $1,920.00 $1,920.00/10.918 = $175.86

$175.86 x 1/25 = $7.03

In determining the applicable fraction, the Court uses a denominator that is determined by subtracting the employee's age when participation in the Plan began from age 65. Defendants may assume that based on their theory – a fractional rule benefit is calculated as though an employee turned age 65 on the date his service ended – the denominator in the applicable fractions should be determined by counting to age 65 as though the employee reached such age on the date employment was terminated. This assumption is unsupportable. If the applicable fraction used a denominator that counted forward only to the date that an employee's service ended, the fraction would always be one, a result that cannot be supported by § 204(b)(1)(C)'s language. To illustrate that the fraction would always be one (and thus there would be no reason for § 204(b)(1)(C) to instruct the usage of a fraction), again consider the hypothetical forty year old. If his service ends in 1998, the numerator will be three (number of years of participation in the Plan). The denominator would also be three because, by treating the employee as if he turned 65 at termination, there are no more years to add by assuming the employee continued working to normal retirement age.

THE CASH BALANCE PLAN

The 1995 PCF was intended to provide a rapid build up of plan value for young and mid-career hires while reducing generous early retirement subsidies. The PCF worked well, and by 1998 IBM had over 20,000 employees between 35 and 55 years of age who had fewer than five years of service. So, in 1998 IBM faced rising pension costs and diminishing pension income as a result of the benefits the company would be paying to their middle aged employees. But, the Plan was not strapped for cash, as there was a surplus of $8 billion at the close of 1997, and the Plan's assets were generating a return greater than what was required to cover the annual costs of providing benefits. Although IBM had not contributed to the Plan for several years, in 1997, 7% of IBM's total reported net earnings was pension income in the amount of $420 million.

In 1999 IBM again amended the Plan and opted for a "cash balance formula" whereby a participant's benefit is determined by reference to a hypothetical account. The Plan's actuaries projected that this CBF would produce annual savings of almost $500 million by 2009. These savings would result from reductions of up to 47% in future benefits that would be earned by older IBM employees.

IBM was aware of the age discrimination issues that would come with the new CBF. Indeed, the Plan's actuaries projected the age 65 annuity benefit earned by a younger employee for a year of service exceeded the benefit earned by an older employee for the same service. And, the actuaries calculated that the amount of an age 65 annuity earned each year by an employee under the CBF

decreased as the employee aged. Nevertheless, the new CBF went into effect July 1, 1999. Due to negative reaction from employees, the Plan was amended a second time in September 1999 to permit more employees to choose between being covered by the new formula or the previous formula.

The CBF had its intended effect. Plan income increased from $395 million in 1998 to $638 million in 1999. Astonishingly, Plan income was over $1 billion in 2001, and this accounted for 13% of IBM's overall net income.

The parties agree that the 1999 Plan as amended is a defined benefit plan. Therefore, the Plan must comply with the many and complex statutory strictures that apply to all defined benefit plans. IBM presents startling anomalies and absurdities that result from pushing the logic that Plaintiffs develop in their argument. But these anomalies and absurdities occur only because the CBF doesn't work within the longstanding statutory framework regarding defined benefit plans. The 1999 Plan looks like a defined contribution plan trying to pass for a defined benefit plan. It doesn't make the cut.

Before testing the CBF under ERISA § 204(b)(1)(H), it is helpful to compare the two types of pension plans authorized by ERISA. A defined contribution plan is easy to describe and understand. The sponsoring employer contributes a specified amount into a separate account for each employee. The risks and rewards of the investment are borne by the employee. The employer does not guarantee a particular result and is off the hook. However, there is no opportunity for the employer to earn pension income or reduce the real costs of the contributions specified in the plan. In this type of plan, the sponsoring employer's

performance is measured by what it puts into the plan. A defined benefit plan is a different creature. The sponsoring employer promises a certain result based upon a formula specified in the plan. The employer must deliver on the promise irrespective of how the funds set aside for this purpose fare in the financial markets. Here, the employer is literally on the hook but has the opportunity to earn pension income and reduce the real costs of funding a pension for employees. In this type of plan, the sponsoring employer's performance is measured by what comes out of the plan in terms of benefits.

A. *Section 204(b)(1)(H)*

The CBF adopted by the 1999 amendment to the Plan creates a hypothetical account referred to as a personal pension account ("PPA") for each participant. Benefits accrue by the addition of "pay credits" and "interest credits" made to the participant's PPA. Future interest payments are guaranteed by the Plan irrespective of a participant's continued employment with IBM.

It is settled that a cash balance plan such as the IBM Plan is held to the same requirements regarding vesting and accrual of benefits as any defined benefit plan. *Esden,* 229 F.3d at 162-63. For each year of qualifying service, such a plan must provide for a definitely determinable, non-forfeitable, "accrued benefit." ERISA § 203(a). The accrued benefit must be expressed in the form of an annual benefit commencing at normal retirement age. 29 U.S.C. § 1002(23). Moreover, the interest credits that are projected and valued as an age 65 annuity must also be taken into account in determining whether a cash balance plan complies with the benefit accrual requirements under

ERISA § 204(b)(1). *Esden,* 229 F.3d at 166, n. 18. This is where the CBF runs afoul of ERISA's age discrimination proscriptions.

Interest credits are a part of the accrued benefit specified in IBM's 1999 Plan, and these count in determining whether the benefit accrual requirements of § 204(b)(1) are met. And, like in any defined plan, the interest credits must be valued as an age 65 annuity. At this point in the analysis, the result is inevitable. In terms of an age 65 annuity, the interest credits will always be more valuable for a younger employee as opposed to an older employee. A noted pension expert summarized matters:

> There is no dispute about the underlying arithmetic of cash balance arrangements: each year, as a cash balance participant ages, the same contribution made for her in the previous year declines in value in annuity terms. Moreover, cash balance arrangements are defined benefit plans and, therefore, measure accrued benefits in terms of annuities, not in terms of the contributions themselves.

Edward A. Zelinsky, *The Cash Balance Controversy,* 19 Virginia Tax Rev. 4, 733 (Spring 2000).

The 1999 CBF violates the literal terms of ERISA § 204(b)(1)(H). IBM's own age discrimination analysis illustrates the problem: a 49 year old employee with 20 years of service accrues an age 65 annuity of $8,093 in the year 2000. The following year, he accrues an additional $622, and by 2010, his additional annual accrual is only $282. This 49 year old employee's benefit accrual has been reduced for each year he has aged, and this reduction violates ERISA § 204(b)(1)(H).

IBM's argument that this example merely illustrates the time value of money at work collapses when the age 65 annuity is included in the analysis. The rate of a participant's benefit accrual diminishes as the participant closes on the age 65 target. And, age 65 is normal retirement age, and Congress did not intend the term "benefit accrual" to mean something different from "accrued benefit." The syntax differs ever so slightly so as to comport with the requirements of good English usage, but the concept is exactly the same.

ERISA does not require an employer to provide a pension plan at all, nor does it favor one type of plan over another. The question is not whether a CBF is a "good" thing. IBM could have accomplished what it has to date by terminating the defined benefit plan and moving to a defined contribution plan According to IBM, this was impractical as the Plan surplus could not have been "tax effectively" withdrawn; but, the point stands. There is nothing in ERISA to prevent IBM from moving to a defined contribution plan that functions like the CBF. There may be policy reasons why Congress should specifically authorize CBFs in the context of defined benefit plans. But the narrow question here is whether the 1999 Plan comports with the literal and unambiguous provisions of ERISA § 204(b)(1)(H), and it does not.

In short, IBM's argument goes to the wisdom of the statutory requirements that Congress adopted regarding defined benefit plans. These requirements were in effect before IBM considered adopting the CBF. IBM, like many other corporate plan sponsors, proceeded with open eyes and was fully informed of the consequences of the litigation that was sure to come. This Court will not perform legal legerdemain by dodging the detail requirements of

ERISA in order to save IBM's 1999 Plan. Plaintiffs' cross motion for summary judgment regarding the CBF adopted by the IBM Plan by an amendment effective July 1, 1999 (Doc. 124) is granted. IBM's cross motion for summary judgment on Plaintiffs' age discrimination claim (Doc. 105) is denied.

B. *Partial Termination*

Defendants' motion for summary judgment on the issue of partial termination is denied because there is a genuine question of material fact (1) whether the July 1, 1999, amendment to the Plan resulted in a decrease in future benefit accruals, and (2) whether any such decrease increased the potential for a reversion. The effects of the subsequent amendment to the Plan which was adopted October 1, 1999, as IBM argues, may make the measurement of the effects of the change unreliable, but this itself constitutes a disputed material fact.

IV. *Conclusion*

Accordingly, Plaintiffs' motion for partial summary judgment on Count I (Doc. 87) is **GRANTED**. Defendants' motion to dismiss for lack of standing (Doc. 103) is **DENIED**. Defendants' motion for summary judgment on the age discrimination claim (Doc. 105) is **DENIED**. Defendants' motion for summary judgment on the § 204(b)(1)(G) claim (Doc. 107) is **DENIED**. Plaintiffs' motion for summary judgment on the cash balance formula (Doc. 124) is **GRANTED**. Plaintiffs' motion for summary judgment on the opening account balance under the cash balance formula (Doc. 127) is **GRANTED**. Defendants' motion for summary judgment on the anti-backloading claim (Doc.

128) is **DENIED**. Defendants' motion for summary judgment regarding the pension credit formula (Doc. 130) is **DENIED**. Defendants' motion for summary judgment regarding partial termination is **DENIED**. Plaintiffs' appeal of the Magistrate's November 1, 2002, Order granting in part and denying in part the motion to compel discovery (Doc. 152) is **DENIED as moot** with leave to reinstate.

There is a triable issue of fact regarding Plaintiffs' anti-backloading claim as well as the partial termination claim. The parties will promptly proceed to develop the issue of what relief the Court should order.

IT IS SO ORDERED.

APPENDIX A

The following motions are before the Court:

(1) Plaintiffs' motion for partial summary judgment on Count I (Doc. 87);

(2) Defendants' motion to dismiss Plaintiffs' § 204(b)(1)(H) claim for lack of standing (Doc. 103);

(3) Defendants' motion for partial summary judgment on Plaintiffs' age discrimination claim (Doc. 105);

(4) Defendants' motion for summary judgment on Plaintiffs' § 204(b)(1)(G) claim (Doc. 107);

(5) Plaintiffs' cross motion for partial summary judgment on Plaintiffs' age discrimination claim with respect to Cash Balance Formula (Doc. 124);

(6) Plaintiffs' motion for partial summary judgment on Count I – comparison formula for opening balances under 1999 cash balance formula (Doc. 127);

(7) Defendants' motion for summary judgment on anti-backloading claim (Doc. 128);

(8) Defendants' motion for summary judgment on Plaintiffs' § 204(b)(1)(H) claim with respect to pension credit formula (Doc. 130);

(9) Defendants' motion for summary judgment on Plaintiffs' horizontal partial termination claim (Doc. 133), and

(10) Plaintiffs' appeal of the Magistrate's November 1, 2002, Order granting in part and denying in part the motion to compel discovery (Doc. 152).

APPENDIX B

Age in Each Year Worked	*Base Points Earned Each Year*	*Excess Points Earned Each Year*
Younger than 30	*7*	*0*
30-34	*9*	*1*
35-39	*12*	*2*
40-44	*15*	*2*
45 and Older	*16*	*3*

APPENDIX C

Age at Termination	*Benefit Conversion Factors*
40	*5.498*
41	*5.773*
42	*6.062*
43	*6.365*
44	*6.683*
45	*7.017*
46	*7.298*
47	*7.590*
48	*7.893*
49	*8.209*
50	*8.537*
51	*8.879*
52	*9.234*
53	*9.603*
54	*9.987*
55	*10.387*
56	*10.439*
57	*10.491*
58	*10.543*
59	*10.596*
60	*10.649*
61	*10.702*

62	*10.756*
63	*10.810*
64	*10.864*
65	*10.918*

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

KATHI COOPER, BETH HARRINGTON, and MATTHEW HILLESHEIM, Individually and on Behalf of All Those Similarly Situated,	)	
Plaintiffs,	)	**CIVIL NO. 99-829-GPM**
vs.	)	
THE IBM PERSONAL PENSION PLAN and IBM CORPORATION,	)	
Defendants.	)	

JUDGMENT IN A CIVIL CASE

(Filed Aug. 16, 2005)

DECISION BY COURT. This matter came before the Court on cross motions for summary judgment and a Class Action Settlement Agreement with Respect to Subclasses 1 and 2 ("Settlement Agreement"). The issues having been duly heard and a decision having been duly rendered,

IT IS ORDERED AND ADJUDGED that judgment is entered in favor of the members of Subclasses 1 and 2 on their claim that the Cash Balance Formula violates ERISA § 204(b)(1)(H). These Class Members are entitled to relief for the violation as provided in the Settlement Agreement.

IT IS FURTHER ORDERED AND ADJUDGED that judgment is entered in favor of the members of Subclasses 1 and 2 on their claim that the Always Cash Balance Formula violates ERISA § 204(b)(1)(H). These

Class Members are entitled to relief for the violation as provided in the Settlement Agreement.

IT IS FURTHER ORDERED AND ADJUDGED that the Plan shall pay Class Counsel fees as an administrative cost of the Plan in accordance with the Settlement Agreement and calculated on a decreasing percentage as follows: (1) an amount equal to 29% of the amount of any Settlement Benefits recovered up to $250 million; (2) an amount equal to 25% of the amount of any Settlement Benefits recovered in excess of $250 million up to the amount of $750 million; (3) an amount equal to 21% of the amount of any Settlement Benefits recovered in excess of $750 million up to the amount of $1,250 million; and (4) an amount equal to 17% requested of any Settlement Benefits recovered in excess of $1,250 million. Class Counsel shall pay incentive awards of $40,000 to Ms. Cooper and $20,000 to Ms. Harrington out of the attorneys' fees paid by the Plan and shall also reimburse themselves for any expenses they already have incurred or will incur in the future out of the attorneys' fees awarded by this Court.

IT IS FURTHER ORDERED AND ADJUDGED that the claims of Subclass 3 were dismissed pursuant to a Rule 54(b) judgment entered on January 10, 2005. All other claims asserted by Plaintiffs in this action are now **DISMISSED with prejudice** pursuant to the terms of the Settlement Agreement and in exchange for the consideration provided therein.

DATED: 08/16/2005

NORBERT G. JAWORSKI,
CLERK

By: s/ Linda M. Cook
Deputy Clerk

APPROVED: s/ G. Patrick Murphy
G. PATRICK MURPHY
CHIEF U.S. DISTRICT JUDGE

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

September 1, 2006

Before

Hon. WILLIAM J. BAUER, Circuit Judge

Hon. FRANK H. EASTERBROOK, Circuit Judge

Hon. DANIEL A. MANION, Circuit Judge

KATHI COOPER, *et al.*, on behalf of a class,

Plaintiffs-Appellees,

No. 05-3588 **v.**

IBM PERSONAL PENSION PLAN and IBM CORPORATION,

Defendants-Appellants.

Appeal from the United States District Court for the Southern District of Illinois.

No. 99-829-GPM
G. Patrick Murphy,
Chief Judge.

Order

Plaintiffs-appellees filed a petition for rehearing and rehearing en banc on August 21, 2006. No judge in regular active service has requested a vote on the petition for rehearing en banc,* and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

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* Circuit Judges Kenneth F. Ripple, Ilana Diamond Rovner and Ann Claire Williams took no part in the consideration of this matter.

FILED
DEC 15 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 06-760

In the Supreme Court of the United States

KATHI COOPER, ET AL., PETITIONERS,

v.

IBM PERSONAL PENSION PLAN, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

A defined benefit pension plan violates ERISA's prohibition against age discrimination "if, under the plan, the rate of an employee's benefit accrual is reduced, because of the attainment of any age." 29 U.S.C. § 1054(b)(1)(H).

The questions presented are:

1. Whether "the rate of an employee's benefit accrual is reduced, because of the attainment of any age," under a cash balance formula in which all employees earn pay credits and interest credits to their retirement accounts at the same rate, regardless of age.

2. Whether "the rate of an employee's benefit accrual is reduced, because of the attainment of any age," under a transition formula in which all employees with the same salary and service history are given the same opening retirement account balance, regardless of age.

No other court of appeals has decided either question; IBM Corporation has frozen its cash balance plan; and the Pension Protection Act of 2006 provides, prospectively, that cash balance plans like IBM's comply with 29 U.S.C. § 1054(b)(1)(H).

RULE 29.6 STATEMENT

International Business Machines Corporation ("IBM") has no corporate parent. No publicly held company owns 10 percent or more of IBM Corporation's stock.

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STATEMENT

Petitioners, a class of current and former IBM employees, seek review of a decision of the Seventh Circuit rejecting their claims that the IBM Personal Pension Plan and a related transition formula discriminate against employees on the basis of age in violation of ERISA. The Seventh Circuit held that the IBM Plan is not age-discriminatory merely because the younger an employee is when he starts his retirement account, the more interest he will accumulate by age 65.

The IBM Plan is a type of defined benefit plan known as a "cash balance" plan. The plan maintains a retirement account for each participating employee. The account is similar to a savings account that accumulates regular savings and interest. Each month, the plan adds a "pay credit" (a percentage of pay) and an "interest credit" (a percentage of the account balance) to the employee's account. All employees earn pay credits and accrue interest at the same rate, regardless of age. Any two employees who work for the plan sponsor for the same number of years and at the same salary will have the same account balance when their service ends, regardless of age.

If an employee's service ends before age 65, and the employee elects to defer receipt of his benefit until age 65, the plan will continue adding interest credits to the employee's account until the employee reaches age 65. The plan adds these interest credits to reflect the time value of money: The credits prevent the employee's retirement benefit from losing its economic value between the time it is earned and the time it is paid. If one employee works for the plan sponsor from age 35 to age 50, and another from age 50 to age 65, the younger employee will accumulate more interest on his account by age 65 than will the older employee, because the younger employee must wait 15 years longer to receive his benefit at age 65.

The district court held that IBM's cash balance plan is age-discriminatory because the younger employee will accumulate more interest by age 65. Pet. App. 21-22, 25. In effect, the court held that *interest* is age-discriminatory. The Seventh Circuit disagreed. The court of appeals held that the younger employee's accumulation of more interest is not "age discrimination" but merely reflects the fact that the younger employee waits longer to receive his benefit and earns interest over a greater number of years. *Id.* at 4. The court stressed that IBM's cash balance formula is age-neutral as to pay credits and interest credits. *Id.* at 2-3, 4-6, 11-12.

When IBM introduced its cash balance plan, it gave each employee an opening account balance. The Plan calculated an employee's opening balance using two transition formulas and gave the employee the larger of the balances yielded by the two formulas. One of the formulas, the "always cash balance" formula, provided an employee with an opening account balance approximately equal to the balance that the employee would have had if the cash balance plan had always been in effect. Under this formula, any two employees with the same salary and service record received the same opening account balance, regardless of age. If the "always cash balance" formula yielded a larger amount than the alternative formula, the employee was given that amount. The district court invalidated the "always cash balance" formula, *id.* at 42; the Seventh Circuit reversed, holding that the formula was not age-discriminatory, *id.* at 12.

1. The Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.* ("ERISA"), governs two basic types of retirement plans: "defined contribution plans" and "defined benefit plans." ERISA §§ 3(34)-(35), 29 U.S.C. §§ 1002(34)-(35). In a defined contribution plan, an employee's retirement benefit is the balance in an account maintained for the employee. The employee's account balance is the employee's share of the contributions made to the plan by the employer and/or the employee, adjusted to

reflect the plan's investment experience. *Id.* § 1002(34). A defined benefit plan is any other retirement plan. *Id.* § 1002(35). Under a defined benefit plan, an employee's retirement benefit generally is based on a benefit formula rather than amounts contributed to the plan. A defined benefit plan is responsible for paying a defined benefit regardless of the plan's investment performance.

A "cash balance plan" is a type of defined benefit plan that expresses an employee's retirement benefit as an account balance consisting of pay credits and interest credits. 26 C.F.R. § 1.401(a)(4)-8(c)(3). A cash balance plan resembles a defined contribution plan, except that an employee's benefit does not depend on the plan's investment performance or on the contributions made to the plan. Pay credits are added to the employee's account at a rate equal to a percentage of the employee's pay; interest credits are added by applying an interest rate to the accumulated account balance. A vested employee who ends his employment before reaching normal retirement age (typically age 65) may elect to receive his retirement benefit immediately or defer receipt until normal retirement age, or later if the plan permits.[1] Interest continues to accrue until the benefit is paid. IRS Notice 96-8, 1996-1 C.B. 359, 1996 WL 17901, at *2 (Feb. 5, 1996).

Cash balance and similar plans today cover nearly one in three participants in defined benefit plans. Between 2001 and 2004, the number of such plans grew from 1,225, with seven million participants, to nearly 1,800, with ten million participants. In 2001, such plans covered 20.5 percent of all defined benefit plan participants; in 2004, they covered 30 percent of all such participants. These plans have flourished even while the overall number of defined benefit plans has declined. In 1985, there

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[1] ERISA generally defines "normal retirement age" as age 65. ERISA § 3(24), 29 U.S.C. § 1002(24).

were 112,206 defined benefit plans; in 2005, there were only 28,796. Pension Benefit Guaranty Corp., *Pension Insurance Data Book 2005*, at 58, 61-62 (2005), *available at* http://www.pbgc.gov/docs/2005databook.pdf.

2. The Age Discrimination in Employment Act of 1967, Pub. L. 90-202, § 12, 81 Stat. 602, 607 (1967) (codified as 29 U.S.C. § 621 *et seq.*) ("ADEA"), forbids employment discrimination based on age. When ERISA was enacted in 1974, the ADEA protected only employees under age 65, and employers could mandate retirement at age 65. Under ERISA, employers did not have to provide pension benefits for services rendered past normal retirement age. See H.R. Conf. Rep. No. 99-1012, at 378 (1986) ("1986 House Report"), *reprinted in* 1986 U.S.C.C.A.N. 3868, 4023.

In 1978, Congress amended the ADEA to raise the minimum mandatory retirement age to age 70. Pub. L. No. 95-256, § 3(a), 92 Stat. 189, 189-90 (1978). Disagreement arose about whether the ADEA, as amended, required plans to provide pension benefits for services rendered after normal retirement age. See 1986 House Report at 378. In a 1978 bulletin, the Department of Labor, which initially administered the ADEA, stated that the ADEA permitted pension plans "to cease benefit accruals and allocations to an employee's account with respect to employees working beyond the normal retirement age under the plan." *Id.* The EEOC, to which the President transferred authority over the ADEA in 1978, announced an intention, never acted on, "to rescind the Department of Labor's interpretation and require employers to continue benefit accruals" for employees who worked past normal retirement age. *Id.*

In 1986, Congress settled the dispute by striking the age-70 limit in the ADEA, Pub. L. No. 99-592, § 2(c)(1), 100 Stat. 1874, 3342 (1986), and amending the ADEA, ERISA, and the Internal Revenue Code of 1986 ("IRC") to prohibit plan sponsors from discontinuing or reducing

benefit accruals for employees who worked past normal retirement age, Pub. L. No. 99-509, §§ 9201, 9202, 100 Stat. 1874, 1973-78 (1986). Section 9202, entitled "Benefit Accrual Beyond Normal Retirement Age," added the new ERISA section, which provides:

> A defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.

ERISA § 204(b)(1)(H)(i), 29 U.S.C. § 1054(b)(1)(H)(i). Similar sections were added to the ADEA and IRC. ADEA § 4(i)(1)(A), 29 U.S.C. § 623(i)(1)(A); IRC § 411(b)(1)(H), 26 U.S.C. § 411(b)(1)(H). The conference committee stated that the three sections should "be interpreted in a consistent manner." 1986 House Report at 378.

3. Petitioners filed this action on November 1, 1999 in the United States District Court for the Southern District of Illinois. The district court certified the case as a class action on September 17, 2001 and entered summary judgment for Petitioners on July 31, 2003.

The district court held that the IBM Plan violates § 204(b)(1)(H) because a younger employee will accumulate more interest on his retirement account balance by age 65 than will an older employee with the same salary and service record. Pet. App. 21-22, 25. The district court acknowledged that this difference in benefits payable at age 65 makes sense "[f]rom an economist's perspective," because the younger employee has longer to wait to receive his benefit, and "[a] dollar today is worth more than the promise of a dollar a year from now." *Id.* at 24. The district court nevertheless concluded that the Plan is unlawful because, in the court's view, § 204(b)(1)(H) does not permit a defined benefit plan to credit an employee's benefit with interest to reflect the time value of money.

The district court based its view on a construction of the term "benefit accrual" in § 204(b)(1)(H). ERISA does

not define that term. In the absence of a definition, the court gave "benefit accrual" the same meaning as "accrued benefit," which appears several times in § 204(b)(1) but not in § 204(b)(1)(H). See §§ 204(b)(1)(A)-(G), 29 U.S.C. §§ 1054(b)(1)(A)-(G). ERISA defines "accrued benefit" as an employee's accrued benefit "expressed in the form of an annual benefit commencing at normal retirement age," – *i.e.*, an age-65 benefit. ERISA § 3(23)(A), 29 U.S.C. § 1002(23)(A). Because "accr ed benefit" refers to an employee's age-65 benefit, the court reasoned, "benefit accrual" must also refer to an employee's age-65 benefit. So construed, the court continued, § 204(b)(1)(H) bars a defined benefit plan from adjusting an employee's benefit by interest to reflect the time value of money, because a younger employee will earn more interest by age 65 than an older employee. The court supposed that Congress used "benefit accrual" instead of "accrued benefit" in § 204(b)(1)(H) to avoid being grammatically "clumsy." Pet. App. 25. Finally, the district court held that the "always cash balance" formula also violated § 204(b)(1)(H). *Id.* at 37, 39.[2]

4. The Seventh Circuit reversed, rejecting the district court's approach of equating "benefit accrual" with "accrued benefit," *id.* at 6-7, and rejecting its conclusion that IBM's Plan is age-discriminatory because "younger employees receive interest credits for more years," *id.* at 3.

Cash Balance Plan. The Seventh Circuit construed § 204(b)(1)(H) to prohibit a plan, because an employee has

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[2] Before the district court entered its August 16, 2005 judgment, Pet. App. 42-43, the parties settled the other issues in the case. Although Petitioners refer to "[t]he monetary relief [conditionally] awarded to the class with respect to the two issues raised by this Petition," Pet. 12, that amount was not "awarded" by the district court but was "provided in the Settlement Agreement," Pet. App. 42. Respondents did not "stipulate[ ]" that the class was "entitled" to that amount. Pet. 1.

reached any given age, from ceasing, or reducing the rate of, an employee's accrual of benefits. Pet. App. 3. In substance, the court held that a plan sponsor would violate § 204(b)(1)(H) by stopping the addition of pay credits to the employee's account, or by reducing the employee's pay credit (*e.g.*, from five percent to three percent of his salary), because the employee had reached a particular age. Observing that "[t]he IBM plan does neither of these things," *id.*, and that "[a]ll terms of IBM's plan are age neutral," *id.* at 2, the Seventh Circuit – after rejecting Petitioners' contrary arguments – held that the IBM plan "complies with the statute," *id.* at 3.

Noting that the district court had "treated the time value of money as age discrimination," *id.* at 4, the court of appeals stated: "Treating the time value of money as a form of age discrimination is not sensible." *Id.* at 5 (citing *Hazen Paper Co.* v. *Biggins*, 507 U.S. 604, 611 (1993)). "Here, as so often, it is essential to separate age *discrimination* from other characteristics that may be correlated with age." *Id.* at 11. "Nothing in the language or background of § 204(b)(1)(H)(i) suggests that Congress set out to legislate against the fact that younger workers have (statistically) more time left before retirement, and thus a greater opportunity to earn interest on each year's retirement savings." Pet. App. 5.

Transition formula. The court of appeals also rejected the district court's holding that the "always cash balance" formula violated § 204(b)(1)(H), noting that the transition formula gave "[e]very employee with the same salary and service record . . . the same opening account balance under the new plan." *Id.* at 12.

5. Following the Seventh Circuit's decision, the President signed into law the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) ("PPA"). Title VII, "Benefit Accrual Standards," added to § 204(b) a new paragraph (5) that ratifies the Seventh Circuit's reading of § 204(b)(1)(H). It provides that a cash balance plan is

not age-discriminatory so long as the "balance of a hypothetical account," as determined on any date, "would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant." PPA § 701(a), 120 Stat. at 981 (adding ERISA § 204(b)(5)(A)(i) & (iv)) Senator Enzi, the Chairman of the Senate Health, Education, Labor, and Pensions Committee and the conference committee, and a floor manager of the Act, stated that the PPA rejected the "confused logic" of treating interest accumulation as age-discriminatory merely "because younger workers could accrue interest on their account over a longer period of time than older workers." 152 Cong. Rec. S8747, S8751 (daily ed. Aug. 3, 2006).

The amendments were made effective June 29, 2005. PPA § 701(e)(1), 120 Stat. at 991 (29 U.S.C. § 1054 (note)). Congress directed that no inference be drawn from the amendments "with respect to . . . the treatment of applicable defined benefit plans or conversions to applicable defined benefit plans before the amendments." PPA § 701(d)(1), 120 Stat. at 991 (29 U.S.C. § 1054 (note)). No court of appeals has yet had occasion to construe the PPA.

6. On January 5, 2006, IBM announced that, as part of a global shift toward defined contribution plans, its defined benefit plans would stop accruing new benefits effective December 31, 2007. Press Release, *IBM Changes U.S. Pension Plans, Effective in 2008, as Part of Ongoing Global Retirement Plan Strategy Shift, at* http://www.03-ibm.com/press/us/en/pressrelease/19090.wss. All benefits earned through year-end 2007 by participants in its cash balance plan will be preserved as of that date. *Id.*

REASONS FOR DENYING THE WRIT

Review should be denied. The court of appeals' decision is correct and does not conflict with any decision of another court of appeals or this Court. As to the lawfulness of cash balance plans, the Pension Protection Act of 2006 resolves the issues in this case for the future; as to the

"always cash balance" transition formula, the decision has little if any significance beyond the parties to this case.

I. THE DECISION BELOW IS CORRECT.

Petitioners assert that review is warranted because the Seventh Circuit's decision is "erroneous," Pet. 13, but the Court's review generally rests on "factors other than the perceived correctness of the judgment below." *Ross* v. *Moffitt*, 417 U.S. 600, 616-17 (1974). Moreover, the Seventh Circuit correctly held that IBM's cash balance plan and transition formula do not violate § 204(b)(1)(H).

Cash Balance Plan. The court of appeals concluded that the IBM Plan complies with § 204(b)(1)(H) because "all terms" of the plan are age-neutral and the plan does not stop the accrual of benefits or change the rate of accrual of benefits because of age. Pet. App. 2-3. The court properly rejected the district court's conclusion that "rate of benefit accrual" in § 204(b)(1)(H) must refer to the rate at which a participant accrues an age-65 annuity. First, because Congress did not use "accrued benefit," a defined term, in § 204(b)(1)(H), it is to be presumed that Congress did not intend to refer to an age-65 benefit. The district court's supposition that Congress used different terms to mean the same thing defies that rule of construction. See *Russello* v. *United States*, 464 U.S. 16, 23 (1983). Second, equating "benefit accrual" with "accrued benefit" would treat the time value of money as age discrimination; such a result is "not sensible." Pet. App. 4-5, 9. Third, cash balance plans are *required* to credit interest to satisfy a non-discrimination safe-harbor in 26 C.F.R. § 401(a)(4)-8(c)(3), and the preamble to that rule states that interest-crediting in cash balance plans is not age-discriminatory. 56 Fed. Reg. 47,524, 47,529 (Sept. 19, 1991).[3]

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[3] Reading "rate of benefit accrual" to mean "accrued benefit" would also disregard "the evils which gave rise to the statute." *United States* v. *Carbone*, 327 U.S. 633, 637 (1946). The "evil"

The court of appeals also properly recognized that Petitioners' claims failed to demonstrate a reduction in the rate of benefit accrual "because of the attainment of any age," – even if "accrued benefit" were read into § 204(b)(1)(H). Pet. App. 11. To discern whether a reduction in the rate of benefit accrual is actually caused by age, the court of appeals recognized, "it is essential to separate age *discrimination* from other characteristics that may be correlated with age." *Id.* The court of appeals correctly recognized that one need look only at IBM's formula "to rule out a violation" because that formula was "age-neutral." *Id.* "[A]ny differences in pension benefits are a function of differing years of service, salary history, or the years the balance has been allowed to compound; age is not a factor." *Id.* at 10-11.[4]

Petitioners assert that the court of appeals ignored "ERISA's differing regulatory treatment of defined benefit and defined contribution plans." Pet. 24. Not so. The court recognized that there is a regulatory distinction between defined benefit plans and defined contribution plans, but the court also recognized that nothing in § 204(b)(1)(H) would "whimsically require" a court to condemn a cash balance plan as "age discriminatory" for crediting interest when interest is not age discriminatory in defined contribution plans. Pet. App. 10. "[T]hat defined-benefit and defined-contribution plans are governed by different

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that gave rise to § 204(b)(1)(H) was stopping benefit accruals for employees who worked *beyond* age 65. See *supra* at 4-5. It would have made no sense, in legislating against that evil, to protect an employee's benefit *at* age 65.

[4] Petitioners' assertion that cash balance plans "admittedly" provide lower benefits to older employees, and that Respondents "intended" this effect, Pet. 1, is false, and the charts produced by Petitioners, Pet. 7, 9, do not show otherwise. Those charts calculate the "rate of benefit accrual" by reference to an employee's age-65 benefit ignoring the time value of money, the approach that the Seventh Circuit rejected.

subsections of ERISA is not to say that what is lawful for one must be forbidden to the other." *Id.* "Interest is not treated as age discrimination for a defined-contribution plan, and the fact that these subsections [governing defined benefit plans and defined contribution plans] are so close in both function and expression implies that it should not be treated as discriminatory for a defined-benefit plan either." *Id.* at 4-5.

Finally, the court of appeals' decision is correct because Petitioners' contrary reading would transform into age discrimination the ordinary and uncontroversial practice of crediting interest. There is nothing in the language, purpose, or background of § 204(b)(1)(H) to suggest that Congress intended such a counterintuitive result. The crediting of interest in a defined contribution plan is lawful, and it would make no sense to treat interest as "age discrimination" in defined benefit plans when that practice is undisputedly not age-discriminatory in defined contribution plans or any other facet of the economy.

If Petitioners are correct, then large numbers of traditional pension plans, some in place since the 1930s, are age-discriminatory as well. Indeed, by the district court's reasoning, even Social Security retirement benefits would be considered age discriminatory because they adjust employees' benefits before retirement by the growth in national average wages and younger employees have more time to accumulate such increases than older employees. U.S. Social Security Administration, *Social Security Benefit Amounts, available at* http://www.ssa.gov/OACT/COLA/Benefits.html.[5]

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[5] Time-value-of-money adjustments in retirement benefits are ubiquitous in defined benefit plans. For example, an employee's pension benefit *must* be adjusted for the time value of money when an employee works past age 70½. IRC § 401(a)(9)(C)(iii), 26 U.S.C. § 401(a)(9)(C)(iii). It would make no sense to find that a practice required for older employees is age discriminatory

Transition Formula. Petitioners' Questions Presented suggest that IBM's cash balance plan and IBM's "always cash balance" formula raise distinct issues. Pet. i. The Seventh Circuit did not think so, see Pet. App. 12, and the Petition itself belies that suggestion: its merits discussion addresses only the cash balance plan. Pet. 14-21. Petitioners acknowledge, moreover, that the issue purportedly raised by the transition formula "is more case specific." *Id.* at 14. In fact, in the district court, IBM's expert and its enrolled actuary testified that they did not know of *any* other plans using a similar transition formula.

Petitioners misstate the basis of the Seventh Circuit's rejection of their challenge to the "always cash balance" formula. Contrary to Petitioners' assertion, the court of appeals did not uphold the formula merely because "older workers' vested benefits [were] not decreased." Pet. 29. The court upheld the formula because it was age-neutral and therefore did not violate § 204(b)(1)(H). Pet. App. 11. The court's observation that employers are free to move from one pension design to another as long as vested benefits are not taken away was not a rationalization for holding that the formula complied with § 204(b)(1)(H); it was an explanation of why it was not "material" that the change in the IBM Plan might have disappointed some employees' future hopes and expectations. *Id.* 12.

Petitioners make much of an email from the Plan's enrolled actuary regarding the formula, Pet. 11-12, 28, but Petitioners present the email out of context. Of the two transition formulas used by the IBM Plan, the "always cash balance" formula was age-neutral, while the alternative formula favored older employees. The age-

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when applied to younger employees. Indeed, § 204(b)(1)(H) itself permits plans to adjust employees' benefits by the time value of money to the extent they defer receiving them until after age 65. 29 U.S.C. § 1054(b)(1)(H)(iii)(II).

neutral "always cash balance" formula therefore provided the larger balance only for younger employees who were disfavored by the alternative formula. Older employees tended to receive their opening account balances under the alternative formula, a fact that Petitioners neglect to mention. Even in Petitioners' example, the older employee has an opening balance of $24,775 while the younger employee, similarly situated, has an opening balance of $19,757. Pet. 11. In no event did a younger employee have a larger opening account balance than a similarly situated older employee as a result of the transition.

II. THERE IS NO CIRCUIT CONFLICT.

The Seventh Circuit's decision does not conflict with any decision of this Court or another court of appeals. Indeed, the court's decision is the only decision by a court of appeals to address whether cash balance plans violate § 204(b)(1)(H).

Cash Balance Plans. The court's decision does not conflict with *Esden* v. *Bank of Boston*, 229 F.3d 154 (2d Cir. 2000), *Berger* v. *Xerox Corp. Ret. Income Guar. Plan*, 338 F.3d 755 (7th Cir. 2003), or *Lyons* v. *Georgia-Pacific Corp. Salaried Employees Ret. Plan*, 221 F.3d 1235 (11th Cir. 2000). Petitioners themselves note that, "[u]nlike the decision below, *Esden*, *Lyons*, and *Miller* did not decide an age discrimination claim under ERISA." Pet. 24. Those cases addressed ERISA's lump sum payment provisions, ERISA § 204(c)(3), 29 U.S.C. § 1054(c)(3); 26 C.F.R. § 1.417(e)-1(d)(1). Unlike § 204(b)(1)(H), these provisions *use* "accrued benefit." These cases do not show that age 65 is the measure when a provision does *not* use the term.

Nor does the court's decision conflict with *Miller* v. *Xerox Corp. Ret. Income Guar. Plan*, 464 F.3d 871 (9th Cir. 2006). *Miller*, too, dealt with a provision that, unlike § 204(b)(1)(H), uses the term "accrued benefit." The court of appeals acknowledged *Miller*'s statement that interest credits in defined benefits plans are "not analogous to the investment growth of a defined contribution," inasmuch

as "[i]nterest in a defined-contribution plan is real, while interest credits in a defined-benefit plan are bookkeeping entries." Pet. App. 10. But the court observed that this is a distinction without a difference for purposes of an age-discrimination analysis.[6]

Transition Formula. The court's rejection of Petitioners' challenge to IBM's "always cash balance" transition formula does not conflict with *EEOC* v. *Jefferson County Sheriff's Dep't*, 467 F.3d 571 (6th Cir. 2006). *Jefferson County*, too, did not construe § 204(b)(1)(H) or involve a cash balance plan or a transition from one pension formula to another. *Jefferson County* simply held that a "facially discriminatory" disability plan is *prima facie* age-discriminatory under the ADEA. *Id.* at 573, 576 ("[T]he KRS plan is facially discriminatory on the basis of age"; "an employee who is 55 or older cannot receive disability retirement benefits."). IBM's "always cash balance" formula is age-neutral: Under the formula, every employee with the same salary and service record received the same opening account balance. Pet. App. 12. Under

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[6] Six of the nine district court decisions addressing the issue have held that cash balance plans are not age-discriminatory. See *Drutis* v. *Quebecor World (USA), Inc.*, No. 04-269-KSF, slip op. at 11 (E.D. Ky. Sept. 25, 2006), *appeal pending*, No. 06-6380 (6th Cir.); *Register* v. *PNC Fin. Servs. Group, Inc.*, No. 04-CV-6097, 2005 WL 3120268, at *7 (E.D. Pa. Nov. 21, 2005), *appeal pending*, No. 05-5445 (3d Cir.); *Tootle* v. *ARINC, Inc.*, 222 F.R.D. 88, 94 (D. Md. 2004); *Eaton* v. *Onan Corp.*, 117 F. Supp. 2d 812, 832-33 (S.D. Ind. 2000). District courts in the Second Circuit are divided. Compare *Laurent* v. *PricewaterhouseCoopers LLP*, 448 F. Supp. 2d 537, 553-54 (S.D.N.Y. 2006) (lawful); *Hirt* v. *Equitable Ret. Plan*, 441 F. Supp. 2d 516, 551 (S.D.N.Y. 2006) (same), *appeal pending*, No. 06-5190 (2d Cir.), and *In re Citigroup Pension Plan ERISA Litig.*, 05 Civ. 5296 (SAS), 2006 WL 3613691 (S.D.N.Y. Dec. 12, 2006) (unlawful); *Richards* v. *FleetBoston Fin. Corp.*, 427 F. Supp. 2d 150, 164-65 (D. Conn. 2006) (same); *In Re J.P. Morgan Chase Cash Balance Litig.*, No. 06 Civ. 732 (HB), 2006 WL 3063424, at *4 (S.D.N.Y. Oct. 30, 2006) (same).

the *Jefferson County* disability plan, moreover, older employees fared worse than younger employees. See 476 F.3d at 576. Under the IBM transition formulas, older employees received an opening balance no lower than younger employees with the same salary and service history, and in most cases received a substantially larger opening balance.

III. THE PENSION PROTECTION ACT OF 2006 RESOLVES THE ISSUE IN THIS CASE FOR THE FUTURE.

Petitioners assert that the "legal consequences of the Seventh Circuit's error are not confined to ERISA age discrimination claims," Pet. 24, but Petitioners do not say what those consequences will be. In fact, there will be none. The PPA provides, prospectively, that cash balance plans comply with the nation's age discrimination statutes. The PPA further provides that a cash balance plan's compliance with § 204(b)(1)(H) and its counterpart ADEA and IRC provisions may be determined by looking to the annual growth of a participant's cash balance account, as the court of appeals did here. Because Congress has affirmed the legality of cash balance plans going forward, review of the meaning and application of § 204(b)(1)(H) is unwarranted. Regardless of any particular outcome in this or any other pending case, cash balance plans will continue to provide employee benefits as a lawful, non-discriminatory feature of the pension system.[7]

CONCLUSION

The petition should be denied.

Respectfully submitted,

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[7] The alleged PPA requirements that Petitioners cite, Pet. 27 n.6, are not applicable to employers like IBM. IBM's Plan is exactly the type of plan that Congress has made clear is legal in the PPA.

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In The

Supreme Court of the United States

KATHI COOPER, et al.,

Petitioners,

v.

IBM PERSONAL PENSION PLAN & IBM CORP.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY TO BRIEF IN OPPOSITION

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REPLY TO BRIEF IN OPPOSITION

IBM's Brief in Opposition (1) concedes that the Seventh Circuit's decision is of paramount national importance because it directly affects the pension benefits of the ten million employees and retirees who participate in cash balance plans; (2) contradicts Judge Easterbrook's holding that cash balance plans and defined contribution plans are economically equivalent; (3) abandons Judge Easterbrook's construction of ERISA's provisions prohibiting age discrimination in pension benefit accrual; and (4) admits that in the few months since the decision below federal district courts have reached diametrically opposed holdings on the core question presented by the Petition: whether cash balance plans violate ERISA Section 204(b)(1)(H)(i) by reducing an employee's rate of benefit accrual based on age.

With respect to the second issue raised by the Petition – whether IBM violated Section 204(b)(1)(H)(i) by using the Always Cash Balance transitional formula favoring younger employees when it adopted a cash balance plan – IBM provides no justification or authority supporting the Seventh Circuit's holding that increasing younger workers' benefits does not violate older workers' rights under ERISA provided that their benefits are not diminished.

I. IBM FAILS TO DEFEND THE SEVENTH CIRCUIT'S MISCONSTRUCTION OF SECTION 204(b)(1)(H)(i).

A. IBM's Brief in Opposition fails to defend – indeed, completely ignores – the centerpiece of Judge Easterbrook's opinion for the Seventh Circuit: its holding that the provisions prohibiting age discrimination in benefit accrual in defined benefit and defined contribution plans are identical despite their radically different terms. Pet. App. 2. This supposed equivalency provided Judge Easterbrook with a statutory basis for ignoring the admittedly

discriminatory rate of benefit accrual under cash balance plans as workers approach normal retirement age.

The foundation for Judge Easterbrook's equivalency holding was his view that cash balance plans and defined contribution plans are economically indistinguishable. However, IBM's Brief in Opposition rejects economic equivalence. IBM says merely that cash balance plans "resemble" defined contribution plans but lack the two core characteristics of such plans: "an employee's benefit does not depend on the plan's investment performance or on the contributions made to the plan." Br. Opp. 3.

IBM's repudiation of Judge Easterbrook's holding of statutory equivalence is consistent with its arguments below. In its Seventh Circuit Reply Brief, IBM conceded that the standards in ERISA Section 204(b)(1)(H)(i) and (b)(2) are different in substance and that discriminatory benefit accrual in cash balance plans is not determined, as Judge Easterbrook subsequently held, by hypothetical contributions to a fictional account but instead by whether the cash balance benefit formula results in a reduction in benefit accrual as the worker's age increases.[1]

However, by distancing itself from Judge Easterbrook's statutory misconstruction, IBM has no statutory support for its alternative arguments defending the

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[1] Here is what IBM said below:

"IBM's construction of § 204(b)(1)(H) dovetails with the statutory distinction between defined benefit plans and defined contribution plans. Defined contribution plans provide a benefit based on contributions and investment returns allocated to individual accounts; Congress therefore subjected such plans to an age discrimination requirement that focuses on the allocations to an employee's account. 29 U.S.C. § 1054(b)(2). Defined benefit plans, by contrast, provide benefits prescribed by a benefit formula; § 204(b)(1)(H) therefore subjects these plans to an age discrimination requirement that focuses on the plan's benefit formula." IBM's 7th Cir. Reply Br. 8.

Seventh Circuit result though not its reasoning. IBM contends that "rate of an employee's benefit accrual" in Section 204(b)(1)(H)(i) cannot "sensibly" refer to "accrued benefit," defined by ERISA for defined benefit plans to mean an employee's annuity at normal retirement age, because that would ignore the "time value of money." But there is nothing in ERISA that justifies discriminatory benefit accrual because of the "time value of money." In contrast, ERISA's defined benefit provisions are focused on the promised annuity at normal retirement age because that benefit is intended to provide the employee's support in retirement. "Rate of an employee's benefit accrual" could not "sensibly" refer to anything else, certainly not to the cash balance plan's hypothetical constructs of "account balance" and "interest credits" which are not even mentioned in ERISA and have no economic reality.[2]

IBM tries to knock down a strawman by contending that plaintiffs assert that the mere payment of interest in a cash balance plan violates Section 204(b)(1)(H)(i). Br. Opp. 11. First, no "interest" is actually paid in a cash balance plan. Second, it is not the payment of interest that is illegal, but instead IBM's guarantee of higher benefits to younger workers at normal retirement age based on the greater number of "interest credits" that younger workers will receive through the cash balance formula than similarly situated older workers. Those higher benefits are entirely the result of age – the number of years the employee has until reaching normal retirement age (65 in IBM's Plan). A 45-year-old worker will receive 20 years of such "interest credits" under the formula while a

[2] IBM's Brief in Opposition (at 3) treats the cash balance "account," "pay credits," and "interest credits" as having economic reality when they are fictions having no substance. IBM's Plan acknowledges that these are mere hypothetical constructs. *See* Petition at 20 n.3.

55-year-old with the same service and salary history will receive only 10 years of "interest credits."[3]

IBM also appears to suggest that Section 204(b)(1)(H)(i) was intended to protect only those employees who have reached normal retirement age. Br. Opp. 4-5, 9-10 n.3. IBM made that argument below, but Judge Easterbrook ignored it and instead applied Section 204(b)(1)(H)(i) to workers of "any age," which is the term Congress used and which permits no limitation in coverage. This Court in *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996), in holding that Section 204(b)(1)(H)(i)'s had no retroactive effect, similarly did not limit its coverage to employees who have already reached normal retirement age. This Court's decision confirms what is clear on the face of the statute: Section 204(b)(1)(H)(i) applies to employees who have not attained normal retirement age. As Judge Scheindlin recently held, "[b]y its own terms, the ERISA age provision protects individuals of all ages." *In re Citigroup Pension Plan ERISA Litigation*, 2006 WL 3613691, at *10 (S.D.N.Y. Dec. 12, 2006) ("*Citicorp*").

Another disconnect between IBM's Brief in Opposition and Judge Easterbrook's opinion arises from their grasping for support from the Treasury Department for their misconstruction of Section 204(b)(1)(H)(i). The only authority cited by Judge Easterbrook for his treatment of cash balance plans as defined contribution plans is the

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[3] IBM's attempted analogies to savings accounts and social security benefits (pp. 1, 11) are clearly invalid. Unlike an employee under a cash balance plan, neither the owner of a savings account nor a social security beneficiary is immediately entitled to interest on his account balance through to normal retirement age. Instead, interest is credited to their accounts solely on a current, annual basis. *See*, in contrast, the Second Circuit's explanation in *Esden v. Bank of Boston*, 229 F.3d 154, 165-166 (2d Cir. 2000), of how an employee under the cash balance benefit formula is legally entitled to interest credits through to normal retirement age on every "contribution" to his account balance.

Treasury Department's proposed cash balance regulations which were never adopted because of Congressional opposition. Pet. App. 6. IBM ignores Judge Easterbrook's reliance on Treasury's proposed but withdrawn regulations, but instead cites one sentence from a 1991 preamble to regulations that did not even deal with age issues. Br. Opp. 9. Moreover, when those regulations were revised two years later, the new preamble did not include that sentence.[4] IBM made this argument below, but Judge Easterbrook ignored it.

B. Unable to defend Judge Easterbrook's opinion, IBM cites the Pension Protection Act of 2006, P.L. No. 109-280, 120 Stat. 780 ("PPA"), enacted a few days after the decision below, as supposedly legitimizing all cash balance plans. Despite months of intense lobbying by corporate sponsors of cash balance plans for retroactive authorization of their plans, Congress specifically refused to provide such immunity. The PPA expressly states that Congress did not intend this new prospective legislation to have any implications on the issue whether cash balance plans prior to the PPA violated Section 204(b)(1)(H)(i).[5] Moreover,

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[4] The regulations dealt with discrimination in favor of highly compensated employees and had nothing to do with age. When the EEOC objected to the preamble sentence because it pertained to age discrimination rather than tax qualification of defined benefit plans, the GAO investigated and reported that "[t]he agencies are continuing to analyze whether cash balance plans are age discriminatory. The continuing regulatory uncertainty surrounding cash balance plans, resulting in part from the preamble sentence, continues to be problematic for employers and plan participants." 7th Cir. Supplemental Appendix at SA-125. One of the leading pension legal scholars, Paul Strella, similarly rejected reliance on the preamble sentence because it was supported by "[n]o explanation, no analysis," was not included in a regulation, and was in a preamble to regulations that did not even deal with age discrimination. *Id.* at SA-72-73.

[5] Section 701(d)(1) of the PPA provides that:

> (d) No Inference. – Nothing in the amendments made by this section shall be construed to create an inference with respect to –

(Continued on following page)

Congress approved cash balance plans prospectively only if they satisfied provisions not found in prior law that protect older workers' benefits from benefit losses of the kind that plaintiffs challenged in this case, such as "wear-away" periods in which benefit accrual is suspended until the employee arrives at the same level of accrued benefits under the terms of the new plan as he had under the prior plan. Plaintiffs made such claims against IBM's Plan in this case, and they were settled for more than $300 million.

C. IBM's Brief in Opposition merely parrots Judge Easterbrook's conclusory holding that the rate of benefit accrual in cash balance plans is "age-neutral" because it depends "on the years the balance has been allowed to compound; age is not a factor." App. 10-11, *quoted* in Br. Opp. 10. Judge Scheindlin has demonstrated the fallacy in Judge Easterbrook's reasoning:

> Defendants also urge this Court to find that a "mere correlation" exists between reduced rates of accrual and older age, because any reduction in rates of benefit accrual is really a function of the time value of money. While this is a fair statement, it is inaccurate to the extent it assumes that the time value of money and age are mutually exclusive. Under a cash balance plan, employees never receive the amount in their hypothetical accounts as their retirement benefit. Instead, the cash balance in the account must be converted to the age 65 annuity. Because this actuarial conversion requires knowing an

---

(1) the treatment of applicable defined benefit plans or conversions to applicable defined benefit plans under sections 204(b)(1)(H) of the Employee Retirement Income Security Act of 1974, 4(i)(1) of the Age Discrimination in Employment Act of 1967, and 411(b)(1)(H) of the Internal Revenue Code of 1986, as in effect before such amendments. . . .

> individual's age, cash balance plans are not age neutral. *Citicorp* at *13 (footnote omitted).

D. IBM's Brief in Opposition refuses to acknowledge the fundamental conflict between the Seventh Circuit in this case and the Second Circuit in *Esden* over the legal nature of cash balance plans. The Seventh Circuit treats such plans as variations of defined contribution plans and therefore focuses on the employee's current, albeit hypothetical, account balance. *Esden*, as well as the Ninth Circuit in *Miller*[6] and the Eleventh Circuit in *Lyons*,[7] focus instead on the accrued benefit in defined benefit plans, which is an annuity at normal retirement age. That this fundamental conceptual conflict controls the issue whether cash balance plans violate Section 204(b)(1)(H)(i) is demonstrated by Judge Scheindlin's recent decision in *Citicorp* in which she rejected the Seventh Circuit's approach in this case as contrary to the language and policy of the statute and followed *Esden*'s focus on the annuity at normal retirement age:

> Although other courts, including the Seventh Circuit, have treated cash balance plans as defined contribution plans for this purpose, doing so would ignore the plain language of the statute as well as the critical distinctions between the types of plans outlined by the Second Circuit in *Esden*. *Citicorp* at *11 (footnotes omitted).

Judge Scheindlin specifically rejected Judge Easterbrook's holding of statutory equivalence between Sections 204(b)(1)(H)(i) and 204(b)(2):

> Underlying [the Seventh Circuit's] interpretation is a presumption that Congress wrote "rate of benefit accrual" in one provision and "allocations

---

[6] *Miller v. Xerox Corp. Retirement Income Guarantee Plan*, 464 F.3d 871 (9th Cir. 2006).

[7] *Lyons v. Georgia-Pacific Corp. Salaried Employees Retirement Plan*, 221 F.3d 1235 (11th Cir. 2000).

> to employee's account" in the other, but intended those phrases to say the same thing. Rules of construction preclude me from adopting this view. . . .
>
> As the Second Circuit has instructed, "[w]hen Congress uses particular language in one section of a statute and different language in another, we presume its word choice was intentional." If Congress had intended for "the rate of an employee's benefit accrual" to mean "the rate at which amounts are allocated to the employee's account," it would have copied those terms from the analogous provision.
>
> The other persuasive argument favoring plaintiffs' interpretation of the statute is ERISA's binary regulatory framework for defined contribution plans and defined benefit plans. This duality exists because defined contribution plans and defined benefit plans make categorically different promises to employees. As a result, the respective anti-discrimination provisions prescribe distinct metrics for detecting discrimination. Specifically, because employees with defined contribution plans are guaranteed employer contributions to retirement accounts but are not guaranteed a retirement benefit, discrimination is better discerned by looking at "the rate at which amounts are allocated to the employee's account." By contrast, because employees with defined benefit plans are guaranteed a retirement benefit ("output"), the sheer "*import* of the statutory language" connotes that "'rate of benefit accrual' refers to the outputs from the Plan." *Id.* at *11-12 (footnotes and citations omitted).

This conflict over the very nature of cash balance plans, of critical importance to millions of American workers, is sufficient to warrant granting the Petition. Indeed, Judge Easterbrook's statutory equivalence holding, which not even IBM can bring itself to defend, is of

paramount national importance in itself because, if unreviewed, it will distort regulation of defined benefit plans in general, not just cash balance plans.

II. IBM CONTENDS THAT YOUNGER WORKERS CAN BE GIVEN DISPROPORTIONATE BENEFIT INCREASES WITHOUT VIOLATING OLDER WORKERS' RIGHTS UNDER ERISA.

IBM admits that the purpose of the Always Cash Balance enhancement was to give proportionately larger benefits to younger workers under the new cash balance plan because the prior traditional defined benefit plan was more advantageous to older workers. Br. Opp. 12-13. IBM argues that as long as all workers with the same service and salary history are treated the same, there is no violation resulting from disproportionate benefit increases for younger workers with fewer years of service and smaller salaries. Neither Judge Easterbrook nor IBM has cited any authority permitting such favoritism toward younger workers. In fact, the Seventh Circuit settled this issue years ago by holding that older workers' rights are violated just as much by giving younger workers' disproportionately more benefits as by giving older workers less. *See Solon v. Gary Community School Corp.*, 180 F.3d 844, 853 (7th Cir. 1999).

IBM's claim that the ACB was age-neutral is false. While the discrimination may not be "facial," it was not far beneath the skin. IBM's actuary told management that older workers would receive only their already accrued benefits in their opening cash balance accounts, while younger workers would receive large unearned increases. Petition at 28. IBM does not deny these facts. The discrimination against older workers is just as clear as in *EEOC v. Jefferson County Sheriff's Dept.*, 467 F.3d 571, 579-580 (6th Cir. 2006) (*en banc*). There, as here, nothing was taken away from older workers, but younger workers

were given additional benefits. The Sixth Circuit ruled the plan clearly illegal because of its favoritism of younger workers; the Seventh Circuit upheld ACB here with no analysis.

IBM's contention that this issue is case-specific is incorrect. As *Jefferson County* demonstrates, favoritism toward younger workers in benefit plans can take many forms, but none is justified. The Seventh Circuit has now thrown that seemingly obvious conclusion into doubt.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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IN THE
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KATHY COOPER, BETH HARRINGTON AND MATTHEW HILLSHEIM,

Petitioners,

v.

THE IBM PERSONAL PENSION PLAN AND IBM CORPORATION,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST[1/]

AARP is a nonpartisan, nonprofit membership organization of more than 37 million persons age 50 or older, working or retired, that is dedicated to addressing the needs and interests of older Americans. Approximately half of AARP's members are working. AARP fosters the economic security of individuals as they age by seeking to increase the availability, security, equity, pension and other employee benefits. AARP and its members have a substantial interest in ensuring that participants have access to pension plans that provide adequate retirement income and that the benefits accrued under a plan are not reduced because of a participant's age. Indeed, AARP has been advocating on the issue of age-based reductions in benefit accruals for over twenty years.

As part of its advocacy efforts, AARP was actively involved in supporting the passage of the Omnibus Budget Reconciliation Act of 1986, PUB. L. NO. 99-509, 100 STAT. 1874 (1986), and the Older Workers Benefit Protection Act, PUB. L. NO. 101-433, 104 STAT. 978 (1990). AARP challenged age-based denial of pension contributions and accruals in court. *See, e.g., AARP v. Farmers Group, Inc.*, 700 F. Supp. 1052 (C.D. Cal. 1988), *aff'd,* 943 F.2d 996 (9th Cir. 1991); *AARP v. EEOC*, 655 F. Supp. 228 (D.D.C.), *rev'd in part*, 823 F.2d 600 (D.C. Cir. 1987); *Snair v. City of Clearwater*, 817 F. Supp. 108 (M.D. Fla. 1993). AARP also has participated as *amicus curiae* in Supreme Court cases

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[1] No counsel for any party authored any portion of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to the preparation and submission of this brief. The written consents of the parties have been filed with the Clerk of the Court pursuant to SUP. CT. R. 37.2(a).

deciding pension and employee benefits issues under the Age Discrimination in Employment Act (ADEA) and the Employee Retirement Income Security Act (ERISA). *See, e.g., Central Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (2004); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996); *Hazen Paper Co. v. Biggins*, 507 U.S. 604 (1993); *Public Employees Retirement Sys. v. Betts*, 492 U.S. 158 (1989); *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989).

Since the late 1990's, AARP began receiving complaints from its members about the loss of their benefits during conversions of traditional defined benefit pension plans to cash balance plans. This came as no surprise inasmuch as commentators generally agree that mid-life and older workers -- AARP's members -- fare the worst in cash balance conversions. *E.g.*, GAO, PRIVATE PENSIONS: INFORMATION ON CASH BALANCE PENSION PLANS 6, 36-38 (GAO/HEHS-06-42, October 2005); E. Schultz, *Actuaries Become Red-Faced Over Recorded Pension Talk*, available at http://www.careerjournaleurope.com/columnists/edchoice/19990505-schultz.html.

Due to the tremendous negative impact cash balance conversions have had on AARP's members' retirement security, AARP vigorously advocated in Congress on numerous bills concerning cash balance plans including the recently enacted Pension Protection Act (PPA), PUB. L. NO. 109-280, 120 STAT. 780 (2006), and the provision in the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, H.R. 2673, 108th Cong. (2004) (H.R. 2673) which blocked implementation of Treasury's proposed regulations and required Treasury to propose legislation providing for transition relief for older and longer-service participants affected by cash balance conversions. *See* Announcement

2004-57, 2004-27 I.R.B. (July 6, 2004). AARP also submitted extensive comments presenting our views on, among other issues, the application of age discrimination statutory provisions to cash balance plans to the Treasury and the Internal Revenue Service on proposed regulations. Even more directly relevant to the question presented here, AARP has participated as *amicus curiae* in cases specifically concerning case balance plans. *Cooper v. IBM*, 457 F.3d 637 (7th Cir. 2006); *Lyons v. Georgia-Pacific Corp.*, 221 F.3d 1235 (11th Cir. 2000); *Hurlic v. Southern California Gas Co.*, No. 2:05-cv-05027-R-MAN (C.D. Cal. March 23, 2006), *appeal docketed*, Case No. 06-55599 (9th Cir. April 21, 2006); *Register v. PNC*, 2005 WL 3120268 (E.D.Pa. 2005), *appeal docketed*, Case No. 05-5445 (3rd Cir. December 16, 2005); *Hirt v. Equitable Retirement Plan*, 441 F.Supp. 2d 516 (S.D.N.Y. 2006); *Engers v. AT&T Corp.*, 2000 U.S. Dist. LEXIS 10937 (D.N.J. 2000) (unpublished).

In light of the significance of the issues presented by this case and the impact on AARP members and other older workers, AARP respectfully submits this brief to facilitate a full consideration by the Court of the questions presented.

REASONS FOR GRANTING THE PETITION

A writ of *certiorari* is appropriate because there is a substantial conflict between the Seventh Circuit's decision in this case and decisions in the Second, Ninth and Eleventh Circuits on the questions presented by the petitioners. *Compare Cooper v. IBM*, 457 F.3d at 639 (7th Cir. 2006) *with Miller v. Xerox Corp. Retirement Income Guarantee Plan*, 447 F.3d 728 (9th Cir. 2006); *Esden v. Bank of Boston*,

229 F.3d 154 (2d Cir. 2000);[2] *Lyons v. Georgia-Pacific Corp.*, 221 F.3d 1235 (11th Cir. 2000). More specifically, this conflict undermines ERISA's objective of national uniform administration of employee benefit plans because many companies with cash balance plans have offices in numerous states in different circuits; indeed, IBM has offices in every state. Moreover, a writ of *certiorari* is appropriate because the Seventh Circuit's decision completely ignores ERISA's statutory scheme which Congress again affirmed most recently with the enactment of the Pension Protection Act (PPA), PUB. L. NO. 109-280, 120 STAT. 780 (2006). Even though there are more than 1,500 cash balance plans covering over 8.5 million workers whose retirement security is being dramatically affected, Jeanne Sahadi, COURT: IBM CASH-BALANCE PENSION IS OKAY (Aug. 7, 2006), available at http://money.cnn.com/2006/08/07/pf/retirement/ibm_pension_ruling/index.htm, in the PPA, Congress decided to address only prospectively the issue of benefit accruals under cash balance plans. Thus, the issue presented by petitioners affects both a substantial number of plans and their covered participants.

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[2] With the issuance of three recent district court decisions, *In re Citigroup Pension Plan ERISA Litig.*, 2006 WL 3613691 (S.D.N.Y. Dec. 12, 2006); *In re J.P. Morgan Chase Cash Balance Litig.*, 2006 WL 3063424 (S.D.N.Y. Oct. 30, 2006); *Richards v. FleetBoston Fin. Corp.*, 2006 WL 3000768 (D. Conn. Oct. 16, 2006), the conflict between the Seventh and Second Circuits has become even more apparent.

ARGUMENT

I. OLDER WORKERS HAVE EXPERIENCED GREATER LOSSES OF EXPECTED BENEFITS IN CASH BALANCE CONVERSIONS THAN YOUNGER WORKERS.

While the first cash balance plan was designed for Bank of America in 1985, cash balance plans were largely unheard of outside of the benefits consulting profession until the second half of the 1990's. Cash balance conversions have since become known as a means by which companies reduce the future pension benefits of their employees, especially older ones. A survey by PriceWaterhouse Coopers found benefit reductions of 20% or more for some employees in 59% of cash balance conversions. PriceWaterhouse Coopers, *Survey of Cash Balance Conversions*, BENEFITS QUARTERLY, 1st Quarter 2001, at 22.

Cash balance conversions have had their most adverse impact on older workers. In late 2005, the U.S. Government Accountability Office released a report on cash balance conversions, finding that older employees experience both greater reductions in future rates of benefit accruals than younger employees, and much lower benefits even though the benefits of younger employees remain roughly comparable to their previous benefits. GAO, PRIVATE PENSIONS: INFORMATION ON CASH BALANCE PENSION PLANS (GAO/HEHS-06-42, October 2005). The plain fact is that the benefits of older employees were reduced more than the benefits of younger employees. *Id.* at 6 and 36-38. Court rulings have also recognized this undeniable fact. *Eaton v. Onan*, 117 F. Supp.2d 812, 818, 831 n.9 and 832 (S.D. Ind. 2000) (older workers have "been getting the worst of both worlds as a result of these [cash balance] conversions"

because they "were too young to derive much benefit from the traditional "final average pay" design, but [were] too old to have gotten an early start in their careers on the benefits of a cash balance plan."); *Campbell v. BankBoston*, 327 F.3d 1, 5 and 8 (1st Cir. 2003) ("pension benefits stop[ped] accruing" in his "final years of service").

The cost savings that companies reap from cash balance conversions are achieved principally by the reduction in the benefits of older workers who are at a point in their careers where they cannot make up this loss of benefits. The cost savings are structured in three ways. First, a conversion changes the benefit formula from one based on final average pay to a formula based on each year's pay (which means that benefits from prior years are no longer adjusted as salaries increase). *Eaton v. Onan*, 117 F. Supp.2d at 818, 831 n.9 and 832; *Campbell v. BankBoston*, 327 F.3d at 5 and 8. Second, to the extent the plan may have provided "subsidized" early retirement benefits, the conversion ends these valuable benefits just before these workers would become eligible for them. Third, and most significantly, most conversions, like IBMs, are characterized by declining rates of benefit accrual for older employees. The Treasury Department finds that cash balance formulas generally produce a "larger accrual for younger employees when measured as the increase in the benefit payable at normal retirement age." 67 Fed. Reg. 76123, 76126 (December 11, 2002). Professor Edward Zelinsky explains:

> Consider, for example, a participant who, at ages thirty-five, forty-five, and fifty-five receives in each year a theoretical contribution of $1000 to her hypothetical cash balance account. As of age sixty-five, the earliest contribution will, in annuity terms, represent

> an annual income of $1094 per year; the $1000 contributed ten years later at age forty-five will constitute at retirement an annuity of $507 per year; and the last $1000 contributed at age fifty-five will, at retirement, represent an annuity of $225 per year. Thus, even though the employee, in defined contribution terms, has been accruing contributions at a steady pace (i.e., $1000 per year), the employee has been earning benefits at a decreasing rate in defined benefit terms.

The Cash Balance Controversy, 19 VA. TAX. REV. 683, 722-23 (2000).

Indeed, actuaries who proposed cash balance plans were well aware of the amount of benefit reductions and who were most affected. E. Schultz, *Actuaries Become Red-Faced Over Recorded Pension Talk, supra* at 2. This Wall Street Journal article quotes an October 1998 Society of Actuaries' meeting where consulting actuaries joked about the benefit reductions:

> Amy Viener, an actuary at William M. Mercer Inc., noted: "You switch to a cash-balance plan where the people are probably getting smaller benefits, at least the older-longer-service people; but they are really happy, and they think you are great for doing it."
>
> An actuary with Watson Wyatt Worldwide who spoke on a panel called "Introduction to Cash Balance/Pension Equity Plans" alongside Ms. Viener, is heard saying on a tape: "It is

> not until they are ready to retire that they understand how little they are actually getting." "Right, but they're happy while they're employed," responded Ms. Viener of Mercer.

Id.

Cash balance plans are designed to reduce the amount older workers earn under cash balance formulas. Not only are older workers earning much less than under the prior defined benefit formulas, but most significantly, they are earning much less than younger workers who are similarly situated in every respect except age. Given the demographics of the United States, this means that these older workers will have less to make ends meet to maintain a secure retirement in their old age, which is the very problem that the 1986 reform was designed to address. *See* Argument II.A, *infra*.

IBM and other corporations that converted to cash balance pension plans "proceeded with eyes wide open and [were] fully informed of the consequences of litigation that was sure to come." *Cooper v. IBM*, 274 F.Supp. 2d 1010, 1022 (S.D. Ill. 2003). With over 8.5 million workers participating in cash balance plans, Jeanne Sahadi, COURT: IBM CASH-BALANCE PENSION IS OKAY (Aug. 7, 2006), *supra* at 4, the issue of the legality of cash balance plan benefit accruals is still significant for all workers, since everyone ages.

II. CASH BALANCE PLANS MUST COMPLY WITH THE RULES FOR DEFINED BENEFIT PLANS.

A. The Nearly Decade-Long Advocacy Effort Was Successful in Ensuring Older Workers' Benefit Accruals Were Neither Eliminated Nor Reduced Because of Age.

Starting in the late 1970's, AARP and others engaged in a nearly decade-long advocacy effort to obtain new rules on benefit accruals for older workers. *See, e.g., Von Aulock v. Smith*, 720 F.2d 176, 182-84 (D.C. Cir. 1983); *AARP v. EEOC*, 823 F.2d. 600, 601-602 (D.C. Cir. 1987). Congress, business, and employee organizations were all aware that defined benefits cost more for older workers than for younger workers if the funding of defined benefit obligations is viewed on a per capita basis. *See, e.g.*, H.R. CONF. REP. 99-1012, 379; 1986 U.S.C.C.A.N. 3868, 4024 ("repeal" of the present law exclusion of older workers from defined benefit participation "may have the effect of increasing an employer's minimum funding requirements significantly for employees hired within five years of normal retirement age").

Indeed, a respected authority in this field shows how, on a per capita basis, the "normal cost" of delivering a $100 per year benefit at age 65 to employees who are currently age 30 can be less than 1/30th of the normal cost of delivering an additional $100 per year benefit to employees when they approach age 65. Dan McGill, FUNDAMENTALS OF PRIVATE PENSIONS at 528 (7th ed. 1996). Defined benefit plans are, however, funded on a group basis. *See Solon v. Gary Cmty. Sch. Corp.*, 180 F.3d 844, 854 n.4 (7th Cir. 1999) ("Broadly speaking, a defined benefit plan is one consisting of a general pool of assets (rather than individualized accounts) from

which an employee, upon retirement, is periodically paid a fixed amount"). There are no actual accounts and no separate individual contributions in defined benefit plans for older versus younger workers. *See Berger v. Xerox*, 338 F.3d 755, 758 (7th Cir. 2003).

When Congress enacted ERISA §204(b)(1)(H) in 1986, with parallel provisions in the ADEA and the Internal Revenue Code, Congress regulated the benefits that defined benefit plans offer and did not make the "bona fide plan" exception a part of its age discrimination standard. *See, e.g.*, ADEA §4(f)(2), 29 U.S.C. §623(f)(2) (bona fide plan exception applies to actions otherwise prohibited under sections (a), (b), (c) or (e), not actions prohibited under section (i)); *Bell v. Trustees of Purdue Univ.*, 975 F.2d 422, 423-24 (7th Cir. 1992) (before 1986 amendments, discontinuing pension benefits after certain ages was not prohibited if the provision was part of a bona fide plan). However, the ADEA safe harbor only applies where the actual amount of payment or the actual cost incurred on behalf of an older worker is not less than that incurred on behalf of a younger person (equal cost or equal benefit rule). *See, e.g.*, 29 U.S.C. §623(f)(2)(B)(i); 29 C.F.R. §1625.10; *Auerbach v. Board of Educ. of Harborfields Cent. Sch. Dist.*, 136 F.3d 104, 112 (2d Cir. 1998).[3] Finally, Congress did not qualify its regulation of benefits in any other way based on the hypothetical "costs" of benefits from a per capita or other non-group perspective.

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[3] *Cooper's* application of an imputed cost analysis conflicts with Congress' express rejection of such a defense for age discrimination in defined benefit plans. *Cooper*, 457 F.3d at 640.

The legislation that came out of the Conference Committee in October 1986 was unquestionably broader in two critical respects than the Senate bill. The Conference understood that if Congress restricted the protection against ceasing of accruals to "after normal retirement age," a plan could decrease an employee's rate of accruals before that age, which is usually age 65. The new law would not be violated because the cessation in accruals occurred prior to age 65. The Conference Committee also understood that the law needed to protect against "reductions" in the rate of accruals before 65. Because at least one of ERISA's "anti-backloading" rules permits "unlimited frontloading" of benefit accruals, no other provision of ERISA would necessarily be violated by such reductions. *See* H.R. CONF. REP. 93-1280, at 274, reprinted in 1974 U.S.C.C.A.N. 5038, 5055-56.

Accordingly, the Conference bill provided that "a defined benefit plan shall be treated as not satisfying the requirements of this paragraph [§204(b)(1)] if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age." It is this language which is at issue in this case.

B. After More than Seven Years of Debate, Congress Recently Revised the Tests Only on a Prospective Basis to Determine Whether Benefit Accruals Decline on Account of Age.

Until the enactment of the Pension Protection Act, Congress never specifically authorized the concept of a "hybrid" plan like a cash-balance plan; instead the "rigidly binary" statutory scheme Congress established regulated

these plans. *Esden v. Bank of Boston*, 229 F.3d 154. Indeed, *Cooper* improperly relied on interpretive regulations the Treasury Department had issued even though Congress made it clear that it disagreed with Treasury's interpretation. *E.g.*, H.R. 2673.

On September 15, 1999, the Internal Revenue Service placed a moratorium on the issuance of tax qualification determination letters involving defined benefit plans that were converted to cash balance plans because Congress had such issues under consideration. Announcement 2004-57, 2004-57 I.R.B. The moratorium is still in effect.

At various times since 1999 Congress refused to legitimize cash balance plans. In 2004, Congress prohibited the implementation of Treasury's proposed regulations which would have retroactively legitimize cash balance plans. H.R. 2673. Instead, Congress required Treasury to propose legislation providing for transition relief for older and longer-service participants affected by cash balance conversions. *Id.* Treasury withdrew its proposed regulations and proposed legislation that would require a five-year "hold harmless" period for current employees following a cash balance conversion, would ban "wearaway" and clarify the legal status of cash balance plans. Announcement 2004-57, 2004-57 I.R.B.

Congress addressed many issues in its recently enacted Pension Protection Act (PPA), PUB. L. NO. 109-280, 120 STAT. 780 (2006). The provisions of the PPA addressing cash balance plans were heavily debated, with business pushing for legitimizing cash balance plans both prospectively and retroactively. Indeed, the bill voted out of the House provided retroactive relief. Pension Protection Act, H.R. 2830, 109th Cong. (2006). The Senate rejected

such broad relief, and instead provided relief for cash balance plans solely on a prospective basis. Pension Security and Transparency Act, S. 1783, 109th Cong. (2006). Congress adopted the Senate bill. House Education and the Workforce Committee Press Release, 4/6/2006, available at http://www.house.gov/apps/list/press/ed31_democrats/rel4606c.html. The PPA provides relief for cash balance plans that are converted from a traditional defined benefit plan exclusively on a prospective basis and, then if, and only if, certain protections are put in place for participants. Section 701(b) of the PPA, PUB. L. NO. 109-280, 120 STAT. 780 (2006). If the cash balance plan does not meet the PPA's requirements, it will fail the age discrimination rules for benefit accruals. *Id.* Congress took no position regarding the legality of cash balance pension plans retroactively. Congress specifically stated that the amendments in the PPA should not give rise to any inference about whether cash balance plans were age discriminatory prior to the PPA's enactment. Section 701(d) of the PPA, PUB. L. NO. 109-280, 120 STAT. 780 (2006). Consequently, the issue of whether benefit accruals are reduced on account of age for the more than 1500 cash balance plans and 8.5 million participants is still unsettled.

C. "The Rate of an Employee's Benefit Accrual" is Based On the Annual Change in the Value of an Annuity at Normal Retirement Age Expressed in Annuity Form.

In *Cooper*, the court stated, without support, that: "there is no statutory difference between the treatment of economically equivalent defined-benefit and defined-contribution plans." 457 F.3d at 639. By this statement, the

Cooper court implicitly rejected the rationale of the decisions in *Miller, Lyons, Berger* and *Esden*.

There are significant differences between defined benefit and defined contribution plans in funding, the nature of the benefits provided, how their benefits are computed, whether they are insured by the PBGC, and how Congress decided to regulate them. *Esden*, 229 F.3d at 158 ("the regulatory consequences of this [defined benefit plan] classification are wide-reaching."); *Lyons*, 221 F.3d at 1251. *Cooper* blatantly ignores the admonition by the Court in *Hughes Aircraft*, that "it is essential to recognize the difference between defined contribution plans and defined benefit plans." *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439 (1999).

By ignoring their essential differences as "whimsical," it was very easy for the Seventh Circuit to make the jump to the conclusion that the rates of benefit accrual for both types of plans should be measured by the same method. However, this ignores the fundamental distinction between the plans concerning the definition of "accrued benefit." As the Court explained, "accrued benefit" in a defined contribution plan is the "balance of the individual's account." ERISA §3(23)(B), 29 U.S.C. §1002(23)(B); *Hughes Aircraft*, 525 U.S. at 439. Thus, age discrimination should be found in defined contribution plans if "the rate at which amounts are allocated to employee's account . . .is reduced, because of the attainment of any age." ERISA §204(b)(1)(A), 29 U.S.C. §1054(b)(1)(A). In contrast, in a defined benefit plan, the "accrued benefit" is defined as "the individual's accrued benefit determined under the plan...[and ordinarily is] expressed in the form of an annual benefit commencing at normal retirement age." ERISA §3(23)(B); 29 U.S.C. §1002(23)(B); *Hughes Aircraft*, 525 U.S. at 440. Thus, age

discrimination should be found in defined benefit plans if "an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age." ERISA §204(b)(1)(H), 29 U.S.C. §1054(b)(1)(H).

Like other tests under ERISA and the Code for defined benefit plans, *e.g.*, IRC §415(a) (to test for top-heavy discrimination, use of benefits in defined benefit plans compared with allocations in defined contribution plans), the defined benefit test focuses on the amount of benefits the employee will receive beginning at normal retirement age; contributions or allocations are irrelevant because there is no individual account to which they may be added. *Berger*, 338 F.3d at 758; *Miller*, 447 F.3d at 735 ("interest credits are defined benefit entitlements specified by the plan terms and are not analogous to the investment growth of a defined contribution plan").

Following *Miller*, *Berger* and *Esden*, the rate of an employee's benefit accrual under a cash balance plan is determined by converting the contents of the Plan's hypothetical "account" into an annuity at normal retirement.[4] "[T]he benefits attributable to interest credits are accrued benefits" and as such "must be valued in terms of the annuity that [they] will yield at normal retirement age." *Esden*, 229 F.3d at 163 and 166; *Berger*, 338 F.3d at 761 ("pension entitlement" is the "pension at age 65 based on his cash balance as increased by future interest credits"); *Miller*, 447 F.3d at 733. It is the benefit commencing at retirement that

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[4] In contrast, the PPA amendments permit an accrued benefit to be expressed in one of three ways including as the balance of a hypothetical account. Section 701(b)(1) of the PPA, PUB. L. NO. 109-280, 120 STAT. 780 (2006).

serves as the yardstick for determining compliance with ERISA § 204(b)(1)(H).

The Treasury Department recognizes, and no one seriously disputes, that cash balance formulas generally offer a "larger accrual for younger employees when measured as the increase in the benefit payable at normal retirement age." 67 Fed. Reg. 76123, 76126. Designed with flat pay credits, or with graded pay credits that flatten out sometime after age 40, many cash balance plans accrue retirement benefits at rates that decrease with advancing age. In terms of an annuity at age 65, the interest credits will always be more valuable for a younger employee as opposed to an older employee. *Richards v. Fleetboston Financial Corp.*, 427 F. Supp. 2d 150, 163 (D. Conn. 2006).

The statutory text shows that Congress purposefully adopted two separate tests for age discrimination under pension plans. The test for a defined benefit plan is based on "the rate of an employee's benefit accrual," whereas the test for a defined contribution plan is based on "the rate of allocations to the employee's account." ERISA §§204(b)(1)(H) and 204(b)(2).[5] When Congress "uses certain language in one part of the statue and different language in another, the court assumes different meanings were intended." *Sosa v. Alvarez-Machain*, 542 U.S. 692, 712 n. 9 (2004). The *Cooper* decision flouts this assumption by construing the phrase "rates of benefit accrual" to mean the same as the term "allocations." In ERISA, Congress showed that it understood the difference between "rate of benefit accrual" and "allocations." *E.g.*, IRC §415(a); *see Richards*, at 164.

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[5] See also ADEA §4(i)(1); IRC §§411(b)(1)(H) & (b)(2).

Moreover, if Congress wanted to offer plan sponsors a cost-based testing alternative for defined benefit plans based on imputed individual costs, it could have done so by modifying the defined contribution test or the EEOC's equal-benefit or equal-cost regulations to allow companies to impute individual costs for the retirement benefits for younger and older workers. 29 C.F.R. §1625.10. However, the legislative history shows that Congress was aware that repeal of the exclusion of older workers from benefit accruals would be costly. It is unthinkable that Congress purposefully enacted two statutory tests, but intended, without enactment, a third test to be implemented depending on a defined benefit plan sponsor's contractual definition of the plan's benefits.[6]

D. Employee Benefit Plan Provisions May Result in Age Discrimination.

Not surprisingly, employee benefit plan provisions have often been found to result in sex or age discrimination. In *City of Los Angeles Dep't of Water & Power v. Manhart*,

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[6] Indeed, Congress has shown it is quite capable of changing pension rules to respond to problems with the statute when it believes it is appropriate. *E.g.*, Older Workers Benefit Protection Act, PUB. L. NO. 101-433, 104 STAT. 978 (1990) (codifying the EEOC's "equal benefit or equal cost" principle for age-based benefit reductions); Omnibus Budget Reconciliation Act of 1990, PUB. L. NO. 101-508, 104 STAT. 1388 (1990) (raised excise tax on pension plan reversions and permitted asset transfers from over funded pension plans to health care accounts for retiree health benefits); Retirement Equity Act, PUB. L. NO. 98-397, 98 STAT.1426 (1984) (requiring plans to pay survivor's benefits to spouses, unless waiver is obtained, to protect spouses).

435 U.S. 702, 716 (1978), the Court held that a plan provision, which was ubiquitous at that time, requiring women to contribute more to a pension plan than men because of women's longevity was a pattern or practice of discrimination. *See also Maki v. Allete, Inc.*, 383 F.3d 740, 745 (8th Cir. 2004) (reversing dismissal of complaint where women alleged that bridging provisions in a pension plan "were adopted in a discriminatory manner"). Reducing benefits based on age, or proxies for age, has also been held to be discriminatory. *See, e.g., Arnett v. CalPERS*, 179 F.3d 690, 695 (9th Cir. 1999), *vacated and remanded on other grounds*, 528 U.S. 1111 (2000) (disability benefits reduced based on potential years to retirement are age discriminatory); *Solon v. Gary Community Sch. Corp.*, 180 F.3d 844, 852-53 (7th Cir. 1999) (early retirement incentives that are reduced for each month employee is over age 58 are discriminatory).

Courts have specifically held that discrimination is not eliminated by framing it in "neutral" economic terms that necessarily correspond with sex or age. In *Arizona Comm. for Deferred Compensation Plans v. Norris*, 463 U.S. 1073 (1983), an employer contended that lower monthly retirement benefits for women employees resulted from a factor other than sex, namely, "longevity." Following *Manhart*, the Court ruled that "one cannot say that an actuarial distinction based entirely on sex is based on any other factor than sex." *Id.* at 1081. Similarly, the Court rejected the alternative contention that the lower monthly payments for women were not discriminatory because they have "approximately the same present actuarial value" as the higher monthly payments for men. *Id.* at 1082-3.

The same principles apply in age discrimination. A "Reasonable Factor Other than Age" cannot be a factor that uses age, directly or indirectly, as a "limiting criterion." 29

C.F.R. §1625.7(c). In *Arnett v. CalPERS*, 179 F.3d at 695, the State of California based disability benefits on 2% of pay multiplied by "potential years of service" to retirement. The Ninth Circuit held that the "practical application" of the formula "leaves no doubt that age at hire ... is the sole basis for lower benefits."[7] *See also EEOC Compliance Manual*, Section 3, Employee Benefits (issued October 27, 2000) (formula that bases benefits on "potential years" to retirement is a proxy for age because it gives younger workers more "constructive years" than older workers).

Like the benefits in *Norris* which could not be calculated without knowing the participant's sex or in *Arnett* which could not be calculated without knowing the participant's age, benefits under a cash balance plan may only be calculated by knowing the participants' age. Thus, the result in *Cooper* contradicts the reasoning underlying *Norris* and its progeny like *Arnett*.[8] Quite simply, in all of these cases the benefit calculation is inseparable from the protected characteristic of age.

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[7] The Court vacated *Arnett* because *Kimel v. Florida Bd. of Regents*, 528 U.S. 62 (2000), ruled that public employees cannot sue State governments under federal age discrimination law. However, the EEOC subsequently refiled the suit and obtained the largest recovery in EEOC history. *See* AARP Magazine, July-Aug 2003, available at, http://www.aarpmagazine.org/lifestyle/Articles/a2003-05-21-mag-justice_age.html.

[8] Unlike the benefits under a cash balance plan, benefits under a flat dollar plan are calculated using participants' years of service; their ages are irrelevant.

CONCLUSION

For these reasons, the petition for a writ of *certiorari* should be granted.

Dated: December 2006

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No. 06-760

In the
Supreme Court of the United States

KATHY COOPER, BETH HARRINGTON and MATTHEW HILLESHEIM,

Petitioners,

v.

THE IBM PERSONAL PENSION PLAN and IBM CORPORATION,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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INTEREST OF THE *AMICUS*[1]

The National Employment Lawyers Association ("NELA") is a professional membership of lawyers who represent employees in labor and civil rights disputes. NELA and its 67 state and local affiliates have a membership of over 3,000 lawyers representing employees on workplace issues. These employees are, for the most part, salaried or non-union employees who do not participate in organizations such as the Chamber of Commerce or the AFL-CIO that regularly file *amicus* briefs. Accordingly, NELA has filed *amicus curiae* briefs to represent them in precedent-setting employment litigation, including the interpretation and application of the Employee Retirement Income Security Act ("ERISA"). *See, e.g., Central Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (2004); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996); *Varity Corp. v. Howe*, 516 U.S. 489 (1996); and *Firestone Tire & Rubber v. Bruch*, 489 U.S. 101 (1989).

NELA members represent participants in pension plans who have a vital interest in enforcing ERISA's protections against age-based reductions in benefit accruals. More specifically, NELA attorneys represent participants in a number of cases involving "cash balance" pension formulas and thus bring considerable experience to this brief.

For these reasons, the *amicus* respectfully requests that its views be considered in support of Petitioners.

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[1] Pursuant to Supreme Court Rule 37.6, the *amicus curiae* states that no person or entity other than the *amicus* and the undersigned counsel made a monetary contribution to the preparation or submission of this brief. No attorney for any party authored this brief in whole or in part. Petitioners and Respondents have consented to the filing of this amicus brief in letters on file with the Clerk of the Court.

REASONS FOR GRANTING WRIT

Congress enacted ERISA §204(b)(1)(H), 29 U.S.C. §1054(b)(1)(H), in 1986 to protect older employees from age-based reductions in their rate of benefit accruals. However, many cash balance formulas, including IBM's, which were adopted after the effective date of that rule accrue retirement benefits at reduced rates as employees grow older. This leaves older workers with lower benefits and thus less income to take care of themselves in retirement. The main argument against a violation is that cash balance formulas rely on the "time value of money." As shown below, these formulas actually reduce benefit accruals by compounding notional credits based on the employee's age until retirement. The Seventh Circuit's analysis conflicts with decisions on the "accrued benefit" under cash balance formulas by the Second, Ninth and Eleventh Circuits and with the Sixth and Ninth Circuits' analyses of age discrimination based on "fewer" years to retirement.

ARGUMENT

I. *Cooper* Contravenes Congress' Intention to Prohibit Age-Based Reductions in the Rate at Which Retirement Benefits Are Earned.

Cash balance formulas "imitate some of the features" of savings plans by referring to employee accounts and hypothetical credits. *Esden v. Bank of Boston*, 229 F.3d 154, 158 (2d Cir. 2000). But the retirement benefits under such formulas are determined by "projecting the cash balance forward" to retirement age and converting the result to an "annuity payable at normal retirement age." *Id.* at 159. When hypothetical credits are compounded over a greater number of years for younger employees "this will result in a larger accrual for younger employees, when measured as the increase in the benefit payable at the normal retirement age." 67 Fed. Reg. 76123, 76126 (Dec. 11, 2002); see also

Edward Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX. REV. 683, 722-23 (2000).[2]

The GAO has found that as a result of cash balance formulas "older workers experience a greater loss of expected benefits than younger workers." The median reduction for workers who were age 50 at the time of a cash balance conversion was $238 per month versus $59 per month for workers who were age 30. U.S.Gov't Accounting Office, PRIVATE PENSIONS: INFORMATION ON CASH BALANCE PENSION PLANS (2005). As a result of the formula changes, older employees earn less retirement income than younger employees for the same years of employment.

A. Congress Enacted ERISA §204(b)(1)(H) to Protect Older Employees' Ability to Accrue Additional Retirement Benefits.

The purpose of the 1974 Employee Retirement Income Security Act ("ERISA") was to ensure "retirement income" for employees. See also ERISA §2(a), 29 U.S.C. §1001(a) (finding that employees are losing "anticipated retirement benefits"). ERISA was enacted after a decade of study brought on by the collapse of the Studebaker company's defined benefit pension plan. See James A. Wooten, *The Employee Retirement Income Security Act of 1974: A Political History* (Univ. of Calif. 2004) at 51-79.

In the mid-1980's, Congress became concerned that many defined benefit plans and some defined contribution

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[2] The disparity between the benefit accrual rates of younger and older employees is greatest when cash balance formulas determine retirement benefits by using notional credits equal to a fixed percentage of pay, as IBM did. Unlike IBM, 74% of cash balance formulas have "graded" pay credit schedules in which the notional credits increase with age, service, or a combination of the two. See Mellon, *2004 Survey of Cash Balance Plans–Report Highlights*, and, e.g., *Esden*, 229 F.3d at 160 (schedule ranged from 3.25% to 11.0%). Although the resulting accrual rates are specific to the schedule, graded schedules generally lessen the age-based reductions in benefit accruals, but do not eliminate them.

plans were still excluding older employees from accruing pension benefits at older ages. Employers had long argued that allowing older employees to participate in defined benefit plans was "costly."[3] Litigation to require the EEOC to invalidate these practices under the ADEA as it then existed was unsuccessful. See, e.g., *Von Aulock v. Smith*, 720 F.2d 176, 182-84 (D.C. Cir. 1983). In *Lockheed Corp. v. Spink*, 517 U.S. 882, 895-96 (1996), this Court addressed the amendments that Congress thereafter enacted to shore up ERISA's protection of older employees. *Spink* held that the rules prohibiting "age-based cessations of benefit accruals and age-based reductions in benefit accrual rates" apply to years of participation after January 1988.

The linchpin of ERISA's protection of retirement income is the "accrued benefit." ERISA distinguishes between defined benefit and defined contribution plans, ERISA §§3(34) and (35), 29 U.S.C. §§1002(34) and (35), and defines the "accrued benefit" separately for each type of plan. ERISA §§3(23)(A) and (B), 29 U.S.C. §§1002(23)(A) and (B). The protective minimum standards that Congress has enacted are based on the "accrued benefit" for each type of plan. Some minimum standards cover both plan types, but their application depends on the "accrued benefit" definition. For example, ERISA establishes minimum vesting rules for "accrued benefits." ERISA §§3(19) and 203, 29 U.S.C. §§1002(19) and 1053. But the "accrued benefit" that vests is different: In a defined benefit plan, it is an annual benefit payable at retirement. In a defined contribution plan it is the balance of the individual's account. ERISA also provides that a plan must satisfy certain "benefit accrual requirements" in ERISA §204, 29 U.S.C. §1054. That section establishes separate rules for defined benefit and defined contribution plans, and the

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[3] See H.R. Conf. Rep. 99-1012, 379; 1986 U.S.C.C.A.N. 3868, 4024; 44 Fed. Reg. 30648-49 (May 25, 1979) (citing 1967 and 1978 ADEA legislative history).

application of those rules again depends on the definition of the "accrued benefit." ERISA's rules on annuities for surviving spouses in ERISA §§205 and 206, 29 U.S.C. §§1055 and 1056, are also based on the "accrued benefit."

In *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999), this Court explained that a defined contribution plan is a plan with a separate "individual account for each participant" where "the employer's contribution is fixed and the employee receives whatever level of benefits the amount contributed on his behalf will provide" in combination with the plan's investment earnings. 525 U.S. at 439. The "'accrũed benefit' for purposes of defined contribution plans means 'the balance of the individual's account.'" *Id.* at 441 n.3.

"A defined benefit plan, on the other hand, consists of a general pool of assets rather than individual dedicated accounts." 525 U.S. at 439. Participants in defined benefit plans are required to "have a right to a certain defined level of benefits, known as 'accrued benefits.' That term, for purposes of a defined benefit plan, is defined as 'the individual's accrued benefit determined under the plan [and ordinarily is] expressed in the form of an annual benefit commencing at normal retirement age.'" *Id.* at 440 (brackets in orig.). It is undisputed that IBM's cash balance plan has a "general pool of assets," with no actual individual accounts. CA App. 242.

The first "cash balance" pension formula is generally attributed to the Bank of America in 1985. See *Lyons v. Georgia-Pacific Corp.*, 221 F.3d 1235, 1238 n.2 (11th Cir. 2000), *cert. denied*, 532 U.S. 967 (2001). Almost all other cash balance formulas were adopted after the January 1, 1988 effective date of ERISA §204(b)(1)(H). Because there are no actual individual accounts or monetary contributions to individual accounts, cash balance formulas are governed by the defined benefit standards. Indeed, three

years before the *Cooper* decision, *Berger v. Xerox*, 338 F.3d 755 (7th Cir. 2003) (Posner) concluded that cash balance formulas must be regulated as defined benefit plans because, unlike a defined contribution plan, "the employee has no actual account, the employer makes no contributions to an employees account, and so there is no account balance to which interest might be added." 338 F.3d at 758. Thus, when a "hybrid" cash balance formula does not comply with the defined benefit plan rules, "for 'hybrid' read 'unlawful.'" *Id.* at 763; accord *Esden*, 229 F.3d at 159 n.6.

It is undisputed that most cash balance formulas violate ERISA §204(b)(1)(H) if the "rate of an employee's benefit accrual" is measured as the increase in the "accrued benefit" payable at retirement age. IBM and other cash balance proponents nevertheless argue that Congress might have intended the term "benefit accrual" in ERISA §204(b)(1)(H) to mean something other than the increase in the "accrued benefit." This argument is based on the point that Congress did not specifically define the term "benefit accrual" in this subsection. However, Congress used this term in adjacent subsections of ERISA §204, again without a specific definition. The context, the ordinary meaning of "benefit accrual," and Congress' and the Federal agencies' consistent use of this term all show that Congress intended for ERISA §204(b)(1)(H) to govern the increase in the "accrued benefit":

> Congress' intent was to assure a benefit measured as of normal retirement age. The value of that benefit does not change, regardless of whether the employee is younger or older than normal retirement age. What it costs to provide the benefit may change depending on an employee's age. However, that was not Congress' concern when it prohibited the diminution of the rate of accrual of the benefit expressed as an annual benefit commencing at normal retirement age.

Richards v. FleetBoston, 427 F.Supp.2d 150, 166 (D.Conn. 2006).

The policy that ERISA §204(b)(1)(H) serves is to ensure that older employees earn additional retirement benefits at the same rate as younger employees. A policy "more accommodating to the design objectives" of cash balance sponsors cannot be substituted for the statutory policy. *Esden*, 229 F.3d at 171.

B. Congress' Intent Is Confirmed by the Meaning of "Benefit Accrual," the Structure of the "Benefit Accrual Requirements" and the Legislative History.

General Dynamics Land Systems v. Cline, 540 U.S. 581, 591 (2004), recognizes that Congress intends "to protect a relatively old worker from discrimination that works to the advantage of the relatively young." Here, ERISA's text and legislative history show that Congress intended to protect relatively older employees' right to earn additional retirement benefits at an equal rate with relatively younger employees. As Judge Baer held in *In re J.P. Morgan Chase Cash Balance Litig.*, __ F.Supp.2d __, 2006 WL 3063424, *6 (S.D.N.Y. 2006), the ordinary meaning of "rate of benefit accrual" is "the rate at which an employee accumulates retirement payments." This ordinary meaning is in line with Congress' consistent use of this term. Congress first used the terms "benefit accrual" and "accrual rate" in ERISA and the 1974 Conference Report to describe the change in a participant's "accrued benefit." The Conference Report states that "In general, the accrued benefit is to be defined in terms of the benefit payable at normal retirement age," and "Each plan [will be] required to satisfy one of three accrued benefit tests (which limit the extent of 'backloading' permitted under the plan)." H.R. Conf. Rep. 93-1280, 273, 1974 U.S.C.C.A.N. 5038, 5055. The Conference Report details how one of those rules, the

"133⅓%" rule, measures the "rate of accrual" or "accrual rate" in different years based on the "accrued benefit." Conf. Rep. at 274, 1974 U.S.C.C.A.N. at 5055-56. All told, the Conference Report uses the terms "benefit accrual," "rate of accrual" and "accrual rate" in twenty places. See 1974 U.S.C.C.A.N. at 5046, 5050-52, 5055-59, 5113, 5180.

When Congress enacted ERISA §204(b)(1)(H) in 1986, it continued this usage. The 1986 Conference Report states that "Present law specifies certain requirements with respect to the rate at which benefits are accrued (i.e., earned) under a pension plan" and it describes those requirements as the "benefit accrual requirements." Conf. Rep. 99-1012, at 375, 1986 U.S.C.C.A.N. 3868, at 4020. The Conference Report illustrates the application of ERISA §204(b)(1)(H) by describing a defined benefit plan that "provides a benefit of $10 monthly per year of service." It concludes that the new rule will require older employees to earn the same "additional benefit of $10 per month." H.R. Conf. Rep. No. 99-1012, at 381, 1986 U.S.C.C.A.N. at 4026. The Conference Report also offers an example where a defined benefit plan provides a retirement benefit under a "fractional rule" formula based on highest average pay and years of participation. The Conference Report states that the new rule will not be violated where 45-year-old and 55-year-old employees "have different accrued benefits because of the different rate of benefit accrual for each year of service" but, consistent with *Cline*, the older employee enjoys a higher rate of benefit accrual than the younger employee. Conf. Rep. at 379; 1986 U.S.C.C.A.N. at 4024. Again, "accrued benefits" are unmistakably based on the "rate of benefit accrual."

Congress' intention is further shown by the context in which ERISA §204(b)(1)(H) appears. The entire statutory section is titled "Benefit Accrual Requirements." The "anti-backloading" rules for defined benefit plans are set out at the start of this section in ERISA §204(b)(1)(A)-(C), 29

U.S.C. §1054(b)(1)(A)-(C). Treasury regulations issued in 1977 specify that the "method provided by the plan for determining accrued benefits [must] satisf[y] at least one of the[se] alternative methods." Treas. Reg. 1.411(b)-1(a).

Because cash balance formulas are not based on highest average pay, the only one of ERISA's accrual rules that a cash balance formula can satisfy is the 133⅓% rule in ERISA §204(b)(1)(B). *Esden*, 229 F.3d at 167 n.18; *Register v. PNC Financial*, 2005 WL 3120268 *3 (E.D. Pa. 2005), appeal pending on other grounds in C.A. 05-5445; *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812, 843 (S.D. Ind. 2000). The 133⅓% rule uses the term "accrual rate" to refer to the "annual rate at which ... a participant can accrue the retirement benefits." The Treasury regulations describe how the 133⅓% rule compares the "rate of benefit accrual" or the "rate of accrual" by looking at the "accrued benefits" earned in earlier and later plan years. Treas. Reg. 1.411(b)-1(b)(2)(iii), Examples (2) and (3), and 1.411(b)-1(g).

The introductory clause to ERISA §204(b)(1)(H) connects the age discrimination rule with the preceding anti-backloading rules:

> Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph [ERISA §204(b)(1)] if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.

With the connection to the "preceding subparagraphs" and the entire paragraph, it is implausible that Congress intended for the phrase "benefit accrual" to have a different meaning in this subparagraph than it has in the preceding rules.

Congress' intent is also manifest in ERISA §204(h), 29 U.S.C. §1054(h), which was enacted only six months before

ERISA §204(b)(1)(H). ERISA §204(h) requires plan administrators to provide advance notice of a significant reduction in "the rate of future benefit accrual." In issuing regulations on this rule, the Treasury Department concluded that "[t]he statutory phrase "rate of future benefit accrual" implies, on its face, that section 204(h) is limited to changes in the accrued benefits." 63 Fed. Reg. 68678, 68680 (December 14, 1998).[4]

Thus, IBM's argument that the "rate of benefit accrual" does not "necessarily" have to be interpreted consistently with ERISA's definition of the "accrued benefit" overlooks the statutory context, Congress' and the Treasury Department's consistent use of the term, and the "presumption that similar language in two labor law statutes has a similar meaning." *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 61 (1987).[5] *Smith v. City of Jackson*, 544 U.S. 228, 233 (2005), emphasized that:

> when Congress uses the same language in two statutes having similar purposes, particularly when one is enacted shortly after the other, it is appropriate to presume that Congress intended the text to have the same meaning in both statutes.

Accord *Varity Corp. v. Howe*, 516 U.S. 489, 510 (1996) (ERISA §502(a)(3) authorizes individual relief against fiduciaries because identical language in §502(a)(5) authorizes such relief); *Harris Trust & Sav. Bank v. Salomon Smith Barney*, 530 U.S. 238, 244-46 (2000).

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[4] Altogether, the Treasury Department has used the terms "benefit accrual," "accrual rate" or "rate of accrual" in 34 sets of regulations related to defined benefit plans. See, e.g., Treas. Reg. 1.401(a)(4)-3(d)(1); 1.410(a)-7(e); 1.411(d)-2(b)(2); 1.411(d)-3(b)(3)(ii); 54.4980F-1, Q&A-6(b) and 8(b).

[5] See also *Deal v. United States*, 508 U.S. 129, 131-32 (1993) (if a term is susceptible to two meanings "all but one ... is ordinarily eliminated by context").

By contrast, when Congress uses terms with distinct meanings like "the rate at which amounts are allocated to the employee's account" in ERISA §204(b)(2), it is presumed that Congress is using the standard legal meaning of those terms and is drawing an intentional distinction. See *Burlington Northern & Santa Fe Ry. v. White*, 126 S. Ct. 2405, 2412 (2006) ("We normally presume that, where words differ...Congress acts intentionally and purposely in the disparate inclusion or exclusion"); *Jama v. Immigration & Customs Enforcement*, 543 U.S. 335, 357 (2005) ("when the legislature uses certain language in one part of the statute and different language in another, the court assumes different meanings were intended"); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1994) ("It is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another, and that presumption is even stronger when the omission entails the replacement of standard legal terminology with a neologism").

II. The Seventh Circuit's Decision Rests on Misguided Policy Analyses.

A. *Cooper* Rests on the Faulty Premise that Cash Balance Formulas Are "Economically Equivalent" to Defined Contribution Plans.

The *Cooper* decision never addresses Congress' use of the terms "accrual rate" and "benefit accrual" in ERISA §§204(b)(1)(B) and (h), but instead holds that the two different age discrimination tests for defined benefit and defined contribution plans in ERISA §§204(b)(1)(H) and (b)(2) "appear to say the same thing." App. 3. While forcefully worded, the *Cooper* decision ignores Congress' and the Treasury Department's consistent use of the terms "accrual rate" and "benefit accrual" and the canon that neologisms should not replace standard legal terminology.

To use the panel's metaphor, the *Cooper* decision went "off the rails" when it conflated the rules for defined benefit and defined contribution plans and ultimately substituted a neologism of "imputed" "inputs" in place of the statutory term "benefit accrual." App. 5.

NELA submits that the Second Circuit's *Esden* decision offers the sounder application of ERISA to cash balance formulas. *Esden* holds that cash balance plans are defined benefit plans which are subject to the"rigidly binary" rules on benefit accruals and the valuation of benefits in ERISA. 229 F.3d at 159 n.6; accord IRS Notice 96-8, 1996-1 C.B. 359, Sec. III.A. The sponsor of a cash balance plan is not permitted to "draft" or "contract around" the statutory requirements through "credits" to fictional accounts. 229 F.3d at 159 n.6 and 173.

Cooper is, by contrast, built on a panel's policy judgment that IBM's benefit formula should be considered "economically equivalent" to that of a defined contribution (aka "savings") plan because older and younger employees under IBM's cash balance formula receive the same hypothetical pay "credits."App. 2-6. In addition to disregarding standard principles of construction, *Cooper*'s policy analysis neglects three indisputable ways in which cash balance formulas and defined contribution plans are not "economically equivalent":

First, despite the imitation of the savings plan terminology, cash balance plans are funded as defined benefit plans: The "employee has no actual account [and] the employer makes no contributions to an actual account." *Berger*, 338 F.3d at 758. Instead, companies fund the benefits under cash balance formulas using the same "pooled" funding methods that apply to other defined benefit plans. *See Esden*, 229 F.3d at 158 n.5 ("the employer retains funding flexibility"). This is not a technical distinction because plans with cash balance formulas have

already been terminated with insufficient funds to pay the plan's benefits. *See, e.g., Burstein v. Allegheny Fdn. Ret. Acct. Plan*, 334 F.3d 365, 370 and 375 (3d Cir. 2003). In defined contribution plans, by contrast, employers are required to make contributions in full each year to a separate individual account, thereby ensuring against underfunding. App.10 (a "defined contribution plan entails fully funded individual accounts").

Second, even when the notional credits under cash balance formulas are not undercut by funding deficiencies, they are often nullified by contractual features, such as "wear-away" provisions under which older employees do not actually earn any additional retirement benefits after the conversion of the plan's formula. See *Richards*, 427 F.Supp.2d at 155 (wear-aways cause employees "to work for many years following [a conversion] without actually accruing any new benefits, despite the existence of a hypothetical cash balance account that show[s] benefits being added each quarter").[6] The individual account structure required for defined contribution plans does not permit contractual features like "wear-aways" that have the effect of nullifying the monetary allocations to an individual's account.

Third, cash balance formulas are unlike defined contribution plans because employees do not share in the plan's actual investment returns, as in a defined contribution plan, but receive whatever notional credits are prescribed by the plan's terms. In *Miller v. Xerox*, 447 F.3d 728, 735 (2006), the Ninth Circuit found that hypothetical "interest credits are defined benefit entitlements specified

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[6] Accord 64 Fed. Reg. 56578, 56579 (Oct. 13, 1999) (as a result of "wear-away" effects, "employees who had already earned benefits may not earn additional retirement benefits for varying periods of time after the conversion"; this effect "continues until an employee's benefit under the ongoing cash balance formula 'catches up' with the employee's protected benefit").

by the plan terms, and are not analogous to the investment growth of a defined contribution plan." The spread between the actual interest credits and actual investment returns permits employers to "credit" interest at one rate while actually earning higher rates. *Esden*, 229 F.3d at 158 n.5 ("the investment experience in excess of the promised interest credits" "belongs to the employer"). Defined contribution plans are not allowed to provide artificially low interest rates when a plan actually earns higher returns.

B. Contrary to *Cooper*'s Assertion that "Nothing Depends on Age," IBM's Accrual Rates Are Reduced by Compounding Notional Credits by the Number of Years Until Retirement, Which Is a "Direct Proxy" for Age.

Cooper justifies its result not with the statutory text, but by attributing the lower benefit accruals for older workers to the "time value of money" or "power of compound interest." App.2-8. *Cooper* asserts that "Nothing depends on age," *id.* at 7, while ignoring the fact that the value of a participant's retirement benefit under IBM's cash balance formula is mathematically determined by compounding notional credits by the number of years the participant has until retirement age. CA App. 381.

The number of years participants have until retirement age is a "direct proxy" for their age. *Erie County Retirees Ass'n v. County of Erie,* 220 F.3d 193, 211 (3d Cir. 2000), *cert. denied*, 532 U.S. 913 (2001). A "reasonable factor other than age" cannot be one that uses age, directly or indirectly, as a "limiting criterion." 29 C.F.R. §1625.7(c). Basing benefits on "potential years" years to retirement is a proxy for age because it means that fewer "constructive years" are

given older workers than younger workers. *EEOC Compliance Manual*, Sec. 3.[7]

The Sixth and the Ninth Circuits have held that providing lower monthly benefits based on older employees' having "fewer" years to retirement is age discrimination. In *Arnett v. CalPERS*, 179 F.3d 690, 695 (9th Cir. 1999),[8] the State of California determined disability benefits with a formula that multiplied 2% of pay by the participant's "potential years of service" to retirement. *Arnett* held that the "practical application" of this formula "leaves no doubt that age at hire ... is the sole basis for lower benefits." In *EEOC v. Jefferson Co.*, 467 F.3d 571 (6th Cir. 2006) (*en banc*), the Kentucky Retirement System ("KRS") offered "lower" disability retirement benefits to employees with "fewer" years to retirement. 467 F.3d at 572 and 586. The Sixth Circuit ruled that the ADEA was violated because the KRS "calculates disability-retirement benefits in such a way that an older employee who is eligible to receive disability benefits receives fewer benefits–in the form of lower monthly payments–than a younger disabled employee." *Id.* at 572. Quoting *Hazen Paper v. Biggins*, 507 U.S. 604, 610 (1993), the Sixth Circuit concluded that the ADEA is violated if "an employee's age...'actually play[s] a role in' and has 'a determinative influence on the outcome' of the amount" of an employee's monthly benefit. *Id.* at 579-80.

Cooper's analysis ignores not only how the reduced rates of benefit accrual are "perfectly correlated" with age under IBM's formula, *Richards*, 427 F.Supp.2d at 168, but also the

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[7] Although no final regulations on ERISA §204(b)(1)(H) have ever been issued, three sets of proposed regulations confirm that age cannot be a limiting factor in determining retirement benefits. *See* 52 Fed. Reg. 45360, 45362 (Nov. 27, 1987); 53 Fed. Reg. 11876, 11880 (Apr. 11, 1988); and 67 Fed. Reg. 76123, 76124 and 76133 (Dec. 11, 2002).

[8] *Arnett* was vacated, 528 U.S. 1111 (2000), because of this Court's decision that public employees cannot sue State governments. But the EEOC refiled the suit and obtained the largest recovery in its history.

fact that ERISA's regulation of defined benefit plans already uses the "time value of money" for a different purpose. ERISA §§204(c)(3) and 205(g)(3), 29 U.S.C. §§1054(c)(3) and 1055(g)(3), provide that if retirement benefits are distributed in a lump sum on a separation from service, the retirement benefit is discounted based on the number of years to retirement age. As a result, younger employees receive lower lump sums on a separation from service because the "present value" of, for example, a $100 per month retirement benefit is lower for a 30 year old than for a 60 year old. However, if a younger employee rolls the distribution over into IRA or 401(k) account, it may grow to the same retirement benefit through the "power of compound interest." The *Cooper* decision posits that defined benefit plans should be considered "age-neutral" only if older and younger employees receive the same distributions on a separation from service. See App. 6 and 11-12. But this is fundamentally inconsistent with ERISA's regulation of lump sum distributions.

Cooper's additional rationales suffer from the same types of flaws. *Cooper* justifies the assertion that "Nothing depends on age" by describing how an age 65 employee can "wait" 40 more years to draw his or her benefits to receive an equal amount of retirement income for a year of participation as an age 25 employee. App.7-8. The decision simply ignores that an age 65 employee who "waits" 40 years is age 105. *Connecticut v. Teal*, 457 U.S. 440, 455 (1982) holds that it is "of little comfort" to the victims that there are some exceptions to the discrimination. It is of less "comfort" for an exception to depend on an individual retiring at age 105.

The *Cooper* decision also misunderstands how the Treasury Department computes the "rate of benefit accrual" by offering this example:

> Consider a formula that adds $500 to annual pension benefits for every year worked.... [O]n the plaintiffs' understanding [this] would be a form of discrimination against the old, because the $500 is a smaller 'rate of benefit accrual' as time passes. Someone who worked two years would get a '100% rate of increase' in his second year (his annual benefits on retirement would jump from $500 to $1,000), while someone who works 20 years receives only a 2.56% growth (from $19,500 to $20,000) in Year 20.

App. 5-6. The "rate of increase" or "growth" percentages in the last sentence show the panel's confusion. Under a unit benefit formula (such as in this example), the "rate of benefit accrual" is the dollar amount of the increase in the retirement benefit. Treas. Reg. 1.411(b)-1(g) ("rate of benefit accrual" for a plan providing $96 per year of service for the first 25 years "is equal in each of the first 25 years of service"). In a plan that bases benefits on a "percentage of a participant's average compensation," the "accrual rate" is the increase in benefits as a percentage of pay. Treas. Reg. 1.411(b)-1(b)(2)(iii) and 1.401(a)(4)-3(d)(1). Neither the Treasury Department nor Congress has ever computed an "accrual rate" in the manner *Cooper* proposes. The "understanding" attributed to the plaintiffs is also wrong. Their position is that ERISA requires equal dollar or percentage-of-pay increases in accrued benefits: In the example, "Someone who worked two years" and "someone who works 20 years" receive the same $500 benefit accrual.

Cooper finally charges that traditional defined benefit formulas that make the "annual pension on retirement...a function of closing salary ... multiplied by the number of years of service" "favor[] older workers" because "wages rise with seniority." App. 11. The opinion suggests that IBM's conversion to a cash balance formula merely removed the "extra benefits to the old." App. 12. In fact, defined benefit formulas based on "closing salary" favor longer-service

workers whose salaries have risen, not older employees as such. An employee who works from age 20 to age 35 is more likely to gain more from a formula that uses "closing salary" than an employee who works from age 60 to 65. In *Hazen Paper*, 507 U.S. at 611, this Court recognized that "age and years of service are analytically distinct ... and thus it is incorrect to say that a decision based on years of service is necessarily 'age-based.'" ERISA §204(b)(1)(H)(ii) further recognizes this distinction by permitting companies to limit the "amount of benefits" or the number of years of service taken into account under such formulas without violating the prohibition on age-based cessations or reductions in accruals. The *Cooper* decision ignores these rules in order to assert that traditional defined benefit formulas favor older workers, while denying the age discrimination under cash balance formulas that is caused by their direct use of age until retirement as the basis for accruing benefits.

Ultimately, the *Cooper* decision overlooks that the court's mission "is to apply the text, not to improve upon it." *Pavelic & LeFlore v. Marvel Enter.*, 493 U.S. 120, 126 (1989). Here, the "dispute is not over what a 'better' regulatory regime, more accommodating to the design objectives of cash balance plans might look like; the dispute is over how to apply the existing regulations to [the] Plan." *Esden*, 229 F.3d at 171.

III. *Cooper* Is in Conflict with *Esden* in the Second Circuit and with the *EEOC v. Jefferson Co.*, *Arnett*, *Miller* and *Lyons* Decisions.

NELA respectfully submits that this Court should grant *certiorari* to address the conflicts between *Cooper* and the Second Circuit's *Esden* decision, the Ninth Circuit's decision in *Miller v. Xerox*, 464 F.3d 871 and the Eleventh Circuit's decision in *Lyons*, 221 F.3d 1235. *Cooper* dismisses the fundamental distinction between defined benefit and defined contribution plans as "irrelevant" or "appear[ing] to

say the same thing." App.3 and 9. It further holds that "Nothing in either ERISA or the IBM plan requires 40 years of interest to be credited to the account as soon as the younger worker earns wages." App. 8.

In *Esden*, the Second Circuit held that a cash balance plan "is a defined benefit plan, not a defined contribution plan" and because of this, the benefits attributed to interest credits "must be valued in terms of the annuity that it will yield at normal retirement age." 229 F.3d at 163-65. Accord *Lyons*, 221 F.3d at 1235 (the "accrued benefit" under a cash balance plan is "calculated under the Plan by projecting forward the amount in [the] hypothetical account using the interest credit rates specified in the Plan"); *Miller*, 464 F.3d at 875 (a "hybrid" plan's "promise of a defined benefit triggered ERISA's defined benefit plan rules, which require that any lump-sum substitute for an accrued pension benefit be the actuarial equivalent of that benefit"); IRS Notice 96-8, 1996-1 C.B. 359, Sec. III.B.1 ("an employee's accrued benefit as of any date before attainment of normal retirement age is based on the employee's hypothetical account balance as of normal retirement age, including future interest credits to that age"). These decisions and the IRS's guidance, which is entitled to deference under *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984), are in conflict with *Cooper*'s holding that the distinction between defined benefit plans and defined contribution plans is "irrelevant" and that interest credits to retirement are not part of a participant's "accrued benefits."

Even after the *Cooper* decision, three district courts in the Second Circuit have applied *Esden* in holding that cash balance formulas violate ERISA §204(b)(1)(H) when they offer lower benefit accruals to older employees. See *In re Citigroup Pension Plan ERISA Litig.*, __ F.Supp.2d __, 2006 WL 3613691 *11-13 (S.D.N.Y. 2006); *In re J.P. Morgan*

Chase, 2006 WL 3063424, *6-8; *Richards v. FleetBoston*, 427 F.Supp.2d at 163-64 and 2006 WL 3000768 *2.

Cooper also conflicts with the Ninth Circuit's *Arnett* decision, 179 F.3d at 695, and the Sixth Circuit's *en banc* decision in *EEOC v. Jefferson Co.*, 467 F.3d at 579-80. *Cooper* holds that the fact that "younger workers have (statistically) more time left before retirement, and thus a greater opportunity to earn interest on each year's retirement savings" is attributable to the "power of compound interest," and not age. App. 5-8. By contrast, *Arnett* and *Miller* hold that the "fewer" years that older employees have until retirement is ineluctably based on age and cannot be used as a basis for reducing the monthly benefits they earn.

Finally, this Court should grant certiorari because appeals involving age discrimination in cash balance formulas are already pending in four other circuits: *Register v. PNC Finan.* (3rd Cir., 05-5445) (orally argued December 14, 2006), *Hirt v. Equitable* (2nd Cir., 06-4757), *Drutis v. Quebecor* (6th Cir., 06-6380), and *Hurlic v. So. Cal. Gas* (9th Cir., 06-55599). These appeals, and 14 other district court cases, emphasize the importance of resolving whether ERISA §204(b)(1)(H) protects the accrual of retirement benefits, or notional credits to accounts.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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